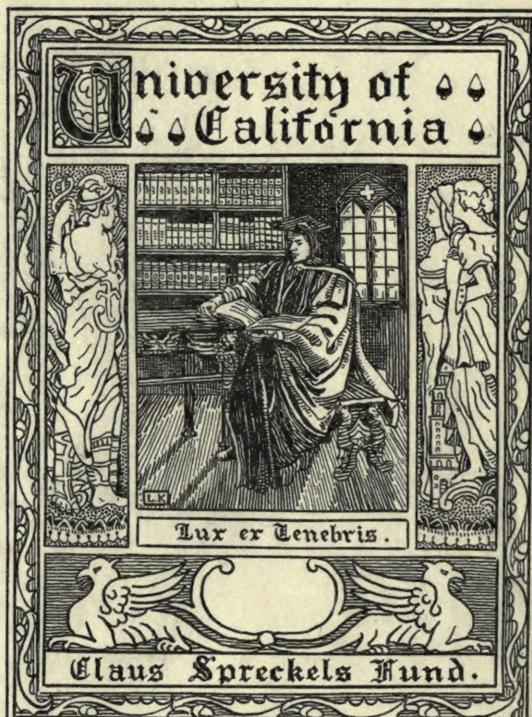
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INCOME *and* FEDERAL TAX REPORTS

BY

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PREFACE

"We are ready to pay our taxes, if only somebody will tell us how." That is the sentiment of every American. To tell them how, is the purpose of this book. I have kept in mind, while writing this book, the fact that the taxpayer will have before him a tax blank to which he will be required to transfer information contained in his books of account. How is that blank to be filled out? Why are the questions asked? Definite, concrete, illustrative answers to these questions, I am sure, will be welcome. I have assumed all along—and I believe my assumption is well-founded—that the taxpayers of America are honest; that they are not asking to evade taxes, but that, on the other hand, they are anxious not to make errors that will subject them to unnecessary tax burdens.

It is a modern American characteristic to spend little time in arguing about the expediency or the wisdom of a certain measure, when it appears more important to get some kind of action concerning that measure. I should have had little patience with a publisher who asked me to write an economic treatise on the income tax. I should have had little desire to undertake the arduous labor of compiling this book had I not felt it a patriotic duty to do what I could to bring the people of the country, upon whom the taxes herein described are to fall, in full sympathy with the law and the administration of the law. The demands of the moment would

have led me to a sympathetic treatment of the tax program of the government, however unjust that program may have seemed to some persons and however just their complaints may have seemed to me. But fortunately there is little basis for complaint. While in some cases the tax rate appears to be high, the scheme of taxation merely follows the time-honored practice of "apportioning public burdens in accordance with the presumed capacity of individuals," and the exigencies of the situation demanded that every individual be required to contribute to his utmost. On the other hand, the reaching down of the government to the incomes of those in moderate circumstances, I believe, will bear its reward in habits of thrift and in a growing sense of responsibility to and for the government, and these rewards will more than offset the temporary small sacrifice that the tax laws require.

I entered upon the compiling of this work with enthusiasm and took from an already busy life every moment possible to complete the book within time to make it of value to the average business man. I must take this opportunity to thank my collaborators heartily for their assistance—not only because it has enabled me to accomplish what otherwise would have been an impossible task, but because their energy and enthusiasm prevented my own spirit from weakening under the fatigue of unbroken effort.

John A. Conlin.

New York University,
February 5, 1918.

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CHAPTER I

INTRODUCTION

The tax program of 1918 based on precedent. — The federal government has been fortunate in being brought into the great European conflict with reasonable notice. We have had time to inquire into the financial expedients of our previous wars. Moreover, we have had the experience of Great Britain and France through three years of extreme stress to guide us. Finally, we have had our difficulties pile up before us gradually, so that our people and our businesses have not been suddenly thrust into a period of heavy tax burdens, but have had time and opportunity gradually to put themselves on a war basis.

It is a notable fact that there is practically nothing new in the present tax program. The excess profits tax is a modern expedient, but we borrowed that from England. The other taxes were used in one form or another in the Civil War.

Civil War taxes.—While most readers will be interested in the 1918 war taxes only to know how they must be met, there will be many who will take a broader interest and who will be ready to inquire how those taxes happened to come about. As we have already indicated, for most of the forms of special taxes that are now being levied there is a precedent, in the taxes which were imposed to meet the demands of the Civil War. Con-

gress levied estate taxes, special taxes on liquors, on articles of common use and on luxuries such as carriages and yachts. There were stamp taxes and income taxes, occupation taxes on financial institutions, and on advertisements. There appears, however, to have been no precedent for the excess profits tax, the tax on admissions to places of amusements and no tax on the mail.

History of Income Taxes.—Of all the taxes enacted during the Civil War the most interesting was the income tax. The original act of August 5, 1861, levied a tax of 3 per cent on incomes over $800. The exemption was later, September 1, 1862, reduced to $600. Incomes received from obligations of the United States were taxed 1½ per cent. Citizens living abroad were taxed at the rate of 5 per cent. Supertaxes of 5 per cent were levied on incomes in excess of $10,000. The law was several times amended, and finally expired by limitation at the end of 1871. It is to be credited with raising $376,290,600.56 for the government, and drew income tax from 276,661 persons.

In 1894 Congress adopted another income tax, but it was held unconstitutional[1] in the following year on the ground that it was a direct tax, and was not, in pursuance to the federal constitution, apportioned among the States. Moreover, it was objectionable, since it did not exempt the interest on State and municipal bonds. In 1909 Congress, in spite of this decision, enacted what was in effect an income tax on corporations, but the Supreme Court validated it by calling it an excise on corporations, assessed "with respect to" incomes. In 1913 the doubt about the validity of federal income taxes was ended with the ratification of the Sixteenth Amendment to the Federal Constitution, which provides: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without appor-

[1] *Pollock v. Farmers' Loan and Trust Co.* (157 U. S. 429; 158 U. S. 601).

tionment among the several States, and without regard to any census or enumeration." Finally, in 1916, the Supreme Court stated "that taxation on income was in its nature an excise," and therefore valid without the aid of the sixteenth amendment.

The Income Tax of 1909.—The tax of 1909 was a tax on corporations only, but the word corporations included joint stock companies or associations organized for profit and having a capital stock, as well as insurance companies, organized under the laws of the United States. Foreign corporations were also liable for the tax, which was applied to that part of their net income which was earned within the United States. Charitable institutions were expressly exempted. Net income was found by deducting from gross income (1) operating and maintenance expenses, including rentals and franchise payments; (2) losses not compensated by insurance, including reasonable depreciation; (3) interest on bonded indebtedness to an amount not exceeding the amount of issued stocks, and interest on deposits, when paid by banks; (4) all taxes of a State or of the United States and all foreign taxes imposed as a condition of carrying on business in foreign countries; and (5) the amount received as dividends from other companies subject to the tax. Reports were due on the first of March covering the income of the previous calendar year, and the tax at the rate of 1 per cent upon the entire net income over and above $5,000 was due on June 30. Penalties were provided for breaches of the law.

The 1909 law is now of historical interest only—the present law does not in any way refer to it, as it does to the true Income Tax laws of 1913 and 1916.

The Income Tax of 1913.—This law was enacted October 3, 1913. It was not intended as a temporary measure, but was intended to bring revenues to the government, which had quite definitely abandoned its almost sole reliance for revenues on import duties.

The law of 1913, popularly known as the Underwood Tariff Bill, was the first valid income tax law since the Civil War. It applied to individuals as well as to corporations. Corporations were taxed upon their entire net income, without the benefit of the exemption of dividends received from another corporation also subject to the tax. Partnerships were to return their income only in case the Internal Revenue Department required such returns to check up the returns of their several partners. Besides an exemption of $3,000 for single persons and $4,000 for married persons, there were deducted from the gross income to find the taxable net income (1) expenses of carrying on any business, (2) interest paid on personal indebtedness, (3) all State and local taxes paid, (4) losses not compensated by insurance, (5) uncollectible debts charged off, (6) a reasonable allowance for depreciation, (7) a credit of dividends received from corporations paying the tax, (8) and income upon which the tax had been collected at the source. Interest received from public securities and salaries of State and local officials were specifically exempted. The normal rate was one per cent. Supertaxes were levied on incomes over $20,000. A novel feature of the tax was the English expedient of collection at the source, by which is meant that all persons or corporations paying to individuals income in the form of wages, interest, rent or the like in excess of $3,000 or $4,000 were required to deduct the one per cent tax and pay it over to the collector.

The Income Tax of 1916.—On September 8, 1916, the law of 1913 was repealed and a new income tax law was enacted. The 1916 law is still in effect, though it has been amended and supplemented by the War Revenue law of October 3, 1917. It is unnecessary at this place to give even a summary of the law of 1916, for it is described at length in the pages that follow; but for the sake of continuing the outline unbroken, we shall

indicate a few of the changes that were made in the law of 1913. The normal tax was raised from 1 per cent to 2 per cent, and the surtax was increased from a maximum of 6 per cent (on incomes over $500,000) to a maximum of 13 per cent (on incomes over $2,000,000). The other principal change was the extension of the $4,000 exemption from married persons to the "head of a family." Deductions were also allowed for taxes paid in foreign countries and for certain kinds of losses, including thefts, and allowances were made for actual depletion of natural resources; these deductions and allowances had not been recognized under the law of 1913. The Treasury Department extended all its rulings under the 1913 act, as far as applicable to the 1916 act.

The income tax provisions of the 1917 War Revenue Law.—The 1917 War Tax Law was approved October 3, 1917. It amended the 1916 law in certain respects but did not repeal it. It also added new extra taxes on income for war purposes. In effect, then, there is now a double tax on income, although it is calculated from a single return. Indeed, from this single return four amounts will have to be calculated: (1) the normal tax of 2 per cent under the 1916 act; (2) the normal tax of 2 per cent under the 1917 act; (3) the supertaxes under the 1916 act; and (4) the supertaxes under the 1917 law. The normal tax under the 1917 law is not to be collected at the source, though this provision still remains in part as to the normal tax under the 1916 law. Further discussion of the details of the income tax features of the War Revenue Act of 1917 is reserved to the chapters dealing with the individual and corporation income tax reports.

Other war taxes in general.—The acts of 1909 and 1913 were enacted before the European war broke out. The revenues designed to be raised from them had nothing to do with a preparedness program. But the act of

1916 was a step toward preparedness and was intended to yield large revenues. For this reason it raised the normal and supertax rates. But it added other features besides the income tax to the federal taxing system. Indeed, it had been preceded, on October 22, 1914, by a War Revenue Law, which laid a special tax on bankers, brokers, commercial brokers, commission merchants, custom-house brokers, pawn-brokers, theater, museum and concert halls, circuses and other public exhibitions, bowling alleys and billiard rooms and on tobacco manufacturers and dealers. This law of 1914 also provided stamp taxes on promissory notes, legal and other instruments, on perfumery, cosmetics and chewing gum, and on liquors and wines.

The law of 1916 made several changes in the act of October 23, 1914, and contained provisions intended to aid certain industries. Among the latter is the increased import duty on dyestuffs.

The Estates Tax.—One of the most important taxes added to the act of 1916 (the other was the munitions tax) was the so-called Estates Tax. Inheritance taxes were used to finance the Civil War. It was proposed to include another such tax in the tariff law of 1909, but the States felt that the federal government should not take away an established source of State income, and their objections were heeded. By 1916 the needs of the federal government, however, had become so great that little difficulty was found in introducing the estates tax provisions into the law of 1916. They provide for a tax on the transfer of the entire estate, the tax being based on the net estate, calculated by deducting from the gross estate, debts, administrative expenses, losses and the like, and also an exemption of $50,000 for residents of the United States. The tax applies to the estate of every decedent whether a resident of the United States or not. Exemption is not, but deductions are allowed on the estates of non-residents in proportion to

the parts of the estates that were situated within the United States, but his provision is conditioned upon receipt of full information by the government.

On March 3, 1917, the Estates Tax law was amended. The rates were raised, and they were again raised by the War Tax Act of October 3, 1917. Under the present scheme the rates of the September 8, 1916, act have been increased by those of the act of March 3, 1917, and these latter are still in effect, but have been added to by the rates imposed by the act of October 3, 1917. The rates in the three acts are as follows:

Estate	Act of Sept. 8, 1917	Act of March 3, 1917, Additional Rates	Act of Oct. 3, 1917, Additional Rates	Total Rate
	%	%	%	%
Not exceeding $50,000	1	½	½	2
Exceeding $50,000 but not $150,000	2	1	1	4
“ 150,000 “ “ 250,000	3	1½	1½	6
“ 250,000 “ “ 450,000	4	2	2	8
“ 450,000 “ “ 1,000,000	5	2½	2½	10
“ 1,000,000 “ “ 2,000,000	6	3	3	12
“ 2,000,000 “ “ 3,000,000	7	3½	3½	14
“ 3,000,000 “ “ 4,000,000	8	4	4	16
“ 4,000,000 “ “ 5,000,000	9	4½	4½	18
“ 5,000,000 “ “ 8,000,000	10	5	5	20
“ 8,000,000 “ “ 10,000,000	10	5	7	22
“ 10,000,000	10	5	10	25

The estates tax as it now stands is to run indefinitely, but will probably be repealed after the war. The additional tax of October 3, 1917, is not to be imposed on the estates of those dying while serving in the military or naval forces of the United States during the present war, or within one year after its close, if death results from injuries or disease contracted in the service.

The Munitions Tax.—The Munition Manufacturers' Tax was enacted as a part of the War Revenue Act of September 8, 1916. It followed, in its purposes, the

somewhat similar taxes of Sweden and Denmark among the neutrals, and of Great Britain, France, Italy and Germany among the combatants. It was originally restricted to a period ending one year after the close of the European war. The latest act, that of October 3, 1917, reduced the tax from twelve per cent to ten per cent upon net profits for the year 1917, and provided that the tax should cease on and after January 1, 1918.

Capital Stock Tax.—In place of the tax of one dollar for each $1,000 of capital employed by banks—a tax originating in the law of October 22, 1914—the law of September 8, 1916, imposed a special excise tax of 50 cents per $1,000 of fair value of capital stock upon every domestic corporation, insurance company or association having a capital stock represented by shares. The legal reserves of insurance companies are not to be included and an exemption of $99,000 is allowed each company. Foreign corporations transacting business within the United States are also subject to this tax at the rate of 50 cents per $1,000 of capital actually employed in the transaction of business in the United States. A proportion of the exemption of $99,000 is allowed these foreign corporations, measured by the ratio of capital employed within the United States to the total capital invested. Title III of the act allows that munition manufacturers are not to be subject to the provisions of this act and those of the Munitions Tax law, but are to be subject to the tax which provides the greatest revenue to the government.

Excess Profits Tax.—Of the various laws thus far mentioned the most important is the Income Tax law. But the most important tax, from the standpoint of yield to the government, is the Excess Profits tax. This tax is expected to raise no less than $1,000,000,000. The Excess Profits tax law was first passed in March, 1917; under the provisions of this act profits in excess of 8 per cent on invested capital were taxed at the rate of

8 per cent. It will be seen that this act differed radically from its prototype, the English Excess Profits tax, which was indeed a tax on excess profits caused by the war. The War Tax law of October, 1917, made material changes in the Excess Profits tax. As the law now stands the basis of the tax is to be found in the "pre-war" period of 1911-12-13. If the profits of that period amounted to less than 7 per cent of the then invested capital, then 7 per cent of the capital for the taxable year is deducted from the net profits before determining the amount of taxable net profits. If the profits of the pre-war period ranged from 7 to 9 per cent, then the actual percentage is used in calculating the proper deduction, but if profits in the pre-war period exceeded 9 per cent, then 9 per cent is taken as the per cent of allowable untaxed profits. Profits in excess of that rate are taxable. Extra allowances of $3,000 for domestic corporations and of $6,000 for partnerships and individuals are made. Further discussion is reserved for the chapter devoted specially to this tax.

On account of the great difficulty that has been experienced in drafting and interpreting the Excess Profits Tax Law, we have added the following description of the English method of computing the tax, taken from the London *Economist,* November 27, 1915:

"This tax is, in fact, an additional income tax imposed on certain trades and businesses, not upon officials, employees, and professional men who are exempt. But any business man or agent who is paid partly by commission is included, except commercial travellers, who are specifically excluded. All salaried persons are excluded, whether their salaries have been stationary or not. Clerks working overtime or persons who have changed one salaried occupation for another with higher remuneration escape taxation. If a small portion of the income is received by way of commission,

as is often the case with company directors or managers, such persons, according to Mr. McKenna (then Chancellor of the Exchequer), do not fall within the scope of the Act, because they do not 'carry on a business.' . . .

"The trades and business liable to the tax include any which are carried on in the United Kingdom or are owned or carried on in any other place by persons ordinarily resident in the United Kingdom. Any business or trade to which the tax applies is liable to pay to the Exchequer a sum equal to 50 per cent of the amount by which the profits for the 'accounting period' exceed by more than £200 the defined pre-war standard of profits. . . .

"It is important to remember that the tax is not a tax upon war profits as such, nor upon high profits *earned* during war conditions, but upon profits *enjoyed* during the war period. . . .

"The computation of the profits of the 'accounting period' is dealt with in Part 1 of the Fourth Schedule. The profits are not to be calculated by income tax rules, but are to be the actual profits of the period, and deductions will be allowed for interest on borrowed money or for rent or royalties or other payments which are excluded under the Income Tax Acts, because income tax on them is collected at the source. On the other hand, all profits or gains from lands, etc., forming part of the assets of the business, which are excluded under the Income Tax Acts because they are taxed under a separate schedule, must be brought into the excess profits computation.

"No deductions for wear and tear or for any expenditure of a capital nature for renewals are allowed, except such as may be allowed under the Income Tax Acts, and then only such amounts as appears to the Commissioners of Inland Revenue to be reasonable and to be properly attributable to the year or account-

ing period. Here practice is to be based upon income tax principles. . . .

"It is provided that without special reasons the sums allowed as remuneration of directors and managers may not exceed the sums allowed in the last pre-war trade year, and no deduction is allowed in respect of any transaction which appears to have artificially reduced the amount of profits. Any transaction already carried through which would have this effect must be disclosed under pain of severe penalties. In the Bill as originally drafted power was given to the Commissioners to examine and make copies of books of account, but this was expunged in Committee.

"Excess profits are to be determined upon the basis of a pre-war standard, which is defined as the average of any two of the last three pre-war trade years; the two years to be selected by the taxpayer. If this amount is less than 6 per cent upon the capital at the end of the last pre-war year in the case of a company, or 7 per cent in the case of any other business, the standard profit is to be taken as equal to 6 per cent, or 7 per cent, as the case may be, upon that capital, and where a business has changed hands within the last three pre-war years or has been started within that period, the percentage standard is to be adopted. Increases in the standard percentage, or adjustments in the pre-war profit standard, may be made by the Board of Referees at their discretion. Mr. McKenna evidently intended the Board to use very wide latitude, for he stated that the 6 per cent allowance upon capital would be ridiculous in the case of rubber plantation companies.

"To meet the case of trades or businesses which have been unduly depressed during the past three years, Mr. McKenna introduced an amendment on November 22, 1915, which provides that where it is proved to the satisfaction of the Commissioners that the last three

pre-war trade years were years of abnormal depression, the average of any four of the last six pre-war trade years may be substituted as the pre-war standard of profits. The last three pre-war trade years may not be considered as years of abnormal depression unless the average profits of those years have been at least 25 per cent lower than the average profits of the preceding three years.

"The manner of assessing the capital is dealt with in Part 3 of the Fourth Schedule, and it is here that interpretation is most difficult. Capital is defined 'so far as it does not consist of money,' as (a) the price at which assets acquired by purchase were purchased, subject to any proper deductions for wear and tear or replacement, or for unpaid purchase money; (b) debts due to the trade or business, subject to any reduction which has been allowed in respect of those debts for income tax purposes; and (c) the value of other assets at the time when they became assets subject to any deductions for wear and tear or replacement. Any capital the income on which is not taken into account in calculating the profits (i.e., interest on investments in the case of companies other than financial companies), and any borrowed money or debts shall be deducted when arriving at the amount of capital for the purpose of the percentage standard allowance.

"The value to be attached to goodwill stands in a very curious position. If a company is assessed upon the pre-war standard basis, goodwill does not enter into the matter at all; but if no pre-war standard is available, the basis of assessment is the percentage standard upon capital. Section 3 of the Fourth Schedule states that where any asset has been paid for otherwise than in cash its cost price shall be the value of the consideration at the time the asset was acquired. But where a business has been sold to a company and the consideration consisted wholly or mainly of shares, no value

shall be attached to those shares so far as they are represented by goodwill, or otherwise than by material assets. This will apply most inequitably to concerns which adopted the joint-stock principle shortly before the outbreak of war and acquired a really valuable goodwill in exchange for shares. A private banking business, for example, generally has a goodwill more valuable than the nominal capital of the business, and if turned into a joint-stock company the partners generally desire to retain a large interest in the business by accepting the greater part of their purchase price in shares. Under the excess profits proposals the shares issued in respect of goodwill will be inadmissible as capital."

What the taxes will yield.[1]—It was estimated that the war taxes would yield in 1918 about $2,500,000,000, as follows:

	Millions
Incomes, individual and corporate	851.0
Excess profits	1,000.0
Spirits, liquors, wines	193.0
Soft drinks, syrups, etc.	13.0
Tobacco, and manufactures thereof	63.4
Freight transportation	77.5
Express transportation	10.8
Passenger transportation	60.0
Pipe lines	4.5
Seats and berths	4.5
Telegraph and telephone messages	7.0
Insurance	5.0
Automobiles	40.0
Musical instruments, etc.	3.0

[1] Later estimates have greatly increased this amount, and now the government expects to receive $1,201,000,000 from income taxes before July 1, including $666,000,000 from individuals and $535,000,000 from corporations. This is more than one-third of the $3,400,000,000 estimated receipts under the War Revenue act passed by Congress at the last session. From excess profits taxes the Government expects to realize about $1,220,000,000 before July 1.

	Millions
Motion picture films	3.0
Jewelry	4.5
Sporting goods	1.2
Pleasure boats	.5
Perfumes and cosmetics	1.9
Proprietary medicines	3.4
Chewing gum	.4
Cameras	.7
Admissions	50.0
Club dues	1.5
Stamp taxes, etc	9.0
Estate taxes	5.0
First-class mail matter	70.0
Second-class mail matter	6.0
Munition manufacturers' tax	25.0
	2,514.8

Income tax yields of previous years.—The following table has been prepared to show the yields to the government of the tax on the incomes of individuals:

	Rate per cent	1913–14 000 Omitted	1914–15 000 Omitted	1915–16 000 Omitted
Normal tax	1	$12,728	$16,500	$23,966
Additional tax on net income of:				
$20,000 to $50,000	1	2,935	4,107	6,092
50,000 to 75,000	2	1,646	2,501	4,071
75,000 to 100,000	3	1,323	2,103	3,624
100,000 to 250,000	4	3,836	5,945	10,936
250,000 to 500,000	5	2,335	3,328	6,394
Exceeding $500,000	6	3,438	6,439	12,648
Settlement in compromise	..	14	63	183
Total	..	28,254	41,046	67,944

In 1917 the collections were as follows:

Normal tax of 2 per cent	$55,742,230.89
Additional tax on net income of:	
$20,000 to $200,000	36,363,894.44
200,000 to 250,000	6,241,807.10
250,000 to 300,000	5,196,876.88
300,000 to 500,000	12,969,686.27
500,000 to 1,000,000	14,501,213.51
1,000,000 to 1,500,000	7,531,893.76
1,500,000 to 2,000,000	4,888,040.10
Exceeding $2,000,000	16,145,856.30
Settlements in compromise	15,994.50
Total	$167,787,089.39

In comparing the year 1913-14 with the other years it must be remembered that the tax fell on the income not of the entire year but of ten months of the year 1913 only.

In 1913 only 357,598 persons made returns. In 1917 this number increased to 437,036. It is estimated that with the decrease in the non-taxable exemption from $3,000 and $4,000 to $1,000 and $2,000 a great many more people will file returns, the aggregate for 1918 being placed at 6,350,000 persons.

Summary.—In a statement issued October 5, 1917, the Commissioner of Internal Revenue, Daniel C. Roper, enumerated the persons subject to the new tax laws. The statement gives the following list:

All individuals receiving incomes of more than $1,000 or $2,000 a year.

All corporations, joint-stock companies and associations.

All distillers, rectifiers, wholesalers and retailers, holders of distilled spirits intended for sale or to be used for manufacturing purposes.

All dealers in fermented liquors and malt liquors, wines, cordials and liqueurs, domestic and imported.

All dealers in soft drinks, table waters and carbonic acid gas.

All manufacturers of and dealers in cigars, cigarettes, tobacco, snuff and cigarette papers.

All carriers of freight, express, or passengers, and all operators of pipe lines.

All dealers in life, marine, inland, fire and casualty insurance. All manufacturers and wholesale dealers in motor vehicles of every kind, [certain mechanical] musical instruments, motion picture films, jewelry, boats, sporting goods, perfumes, cosmetics, medicinal preparations, chewing gum and cameras.

All proprietors of amusement places, including cabarets. All persons executing legal documents of any type.

All traders on produce or stock exchanges and boards of trade. All importers of merchandise.

All manufacturers and importers of playing cards.

Duty of persons to file returns and pay the tax.—Every citizen and every person resident in the United States is bound to make a return if his income is over $1,000 or $2,000, as the case may be. The duty of citizens was stated by Commissioner Roper as follows:

"Upon every citizen rests the responsibility of contributing to the utmost of his ability toward the successful termination of the war. The War Revenue Act represents the judgment of the United States Congress as to what is the proper share for each citizen to contribute. This share is based upon the ability of the citizen to contribute. It is the unquestioned duty, therefore, of every true American citizen not only to pay the full tax the law requires of him, but to remove every possible obstacle to the successful administration of the law by the Bureau of Internal Revenue. In the circumstances, it is a high privilege for every citizen to comply strictly with the terms of the law and to make it a part of his duty to see that every other citizen does likewise."

CHAPTER II

ADMINISTRATION

Organization of the Internal Revenue Bureau.—The administration of the internal revenue laws is in the hands of the Bureau of Internal Revenue, a division of the Treasury Department. This bureau, which is now under the direction of Commissioner of Internal Revenue Daniel C. Roper, is charged with the administration of all internal revenue laws and with the collection of taxes imposed by these laws. The amount of taxes collected by this bureau has increased greatly in the past four years, the increase being due almost entirely to the enactment of the Income Tax law. The new "war taxes" are expected to result in such an increase in the amount of taxes that the bureau has been entirely reorganized in anticipation of its great task. An idea of the immensity of this task may be obtained from the fact that the government's estimate of the amount of internal revenue for its fiscal year ending June 30, 1918, is $3,500,000,000 as compared with $750,000,000 collected for the fiscal year ended June 30, 1917.

The Commissioner of Internal Revenue is responsible to the financial executive of the country, the Secretary of the Treasury. The Secretary has called to the Commissioner's assistance two advisory boards, (1) the Legal Advisory Board and (2) the Excess Profits Advisory Board.

The Legal Advisory Board is composed of a number of the leading lawyers of the United States. This Board will advise the Treasury Department in all legal

matters arising through the enforcement of the various tax laws.

The members of the Excess Profits Advisory Board are: Representative Cordell Hull, a member of the House Committee on Ways and Means; T. S. Adams, economist, of Yale University; Wallace D. Simmons, President, Simmons Hardware Co., of St. Louis and Philadelphia; J. E. Sterret, of Price, Waterhouse & Co., accountants, of New York City; S. R. Bertron, of Bertron, Griscom & Co., bankers, of New York City; E. T. Meredith, of Des Moines, Iowa, editor of *Successful Farming;* T. W. McCullough, editor of the *Omaha Bee,* of Omaha, Nebr.; Stewart W. Cramer, of the National Association of Cotton Manufacturers, Charlotte, N. C., and Henry Walters, Chairman of the Board of the Atlantic Coast Line and Louisville & Nashville Railways.

In announcing the appointment of the Board, Secretary McAdoo said: "The Government is fortunate in obtaining as advisors men of such broad vision and experience, who are patriotically interested in seeing that the money so vitally needed for war purposes is collected with the least inconvenience to the public and to business generally."

The Internal Revenue Bureau is divided into six divisions, each division in charge of a deputy commissioner or supervisor.

The first three divisions take care of the regulations regarding the collection of the various taxes. The Income, Excess Profits and Munitions taxes are under the supervision of one deputy commissioner. The Tobacco, Distilled Spirits, Capital Stock, and Estate taxes form the second division, the third division covering the Miscellaneous and Sales taxes. The deputy at the head of each division is charged with the duty of making all necessary regulations for the collection of the taxes under his control. The regulations issued by these

deputies must have been approved by the Commissioner of Internal Revenue.

The fourth department has charge of the actual collection of the tax. The head of this division has the official title of Supervisor of Collectors' Offices, and is responsible for organization, methods and personnel.

The fifth division, under the Chief Revenue Agent, is in charge of the inspection of returns. The work of this department in seeing that the taxes are paid by every one subject to them is discussed in detail later in this chapter.

The sixth division covers an entirely new phase of governmental activity. The creation of the Division of Business Cooperation is a recognition of the fact that the taxpayer as well as the government is interested in the methods of collecting the taxes. The work of this division is twofold; it is to act as an educator and also as an adjuster. It is estimated that 7,000,000 more people will file income tax returns for 1917 than did for 1916. It is necessary, therefore, to educate the public as to the requirements of the new law. The Division of Business Cooperation is conducting a national campaign of education, cooperating with Chambers of Commerce, Boards of Trades, manufacturers' organizations and other volunteers. The second function of the Division is to act as an adjuster between the tax payer and the government. All complaints and suggestions for improvements in the operation of the law will be handled through this department.

How the tax laws are interpreted.—In the administration of the internal revenue laws by the Treasury Department, the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, prepares sets of "Rulings" covering questions of interpretation and administration of the tax law, theretofore enacted by Congress. These rulings are given a number and are then known by that number. The last general com-

pilation of rulings on the Income Tax was issued on January 5, 1914, and is known as Regulations No. 33.

From time to time the Commissioner of Internal Revenue issues formal "Treasury Decisions" (the so-called "T. D.'s"). These have the approval of the Secretary of the Treasury and serve the purpose of explaining some feature of the regulations or of the law itself. Besides these formal rulings, the Department, in answer to inquiries made by collectors or by taxpayers, usually through the collectors, gives mimeographed rulings or opinions, sometimes referred to as "Letters." These letters refer to matters not important enough to become the subject of a formal decision. The contents of some letters are given to the public and are taken into account in the explanation of various matters in this book.

Whenever a rule or regulation is issued it supersedes previous rulings on the same subject. The Department has the power to make these rulings retroactive, since the rulings do not affect the law but merely interpret it. The Department, however, has in several cases refrained from enforcing its ruling retroactively in cases where property rights would be affected as between different persons or groups of persons.

Court Decisions.—Other decisions which affect the law are the interpretations of the court. If a taxpayer is dissatisfied with the ruling of the department he may bring an action in one of the District Courts, and may appeal from the decision of this court to the United States Supreme Court. The Department ordinarily will be guided by the decision of the final court, but of course may claim that the facts in any given case do not fit exactly the decision in the previous case. The taxpayer in such a case may be compelled to take his case to the court.

How the law will be construed.—The main purpose of the courts in deciding any case is to discover the true

intent of the legislature and then give to the law such an interpretation as will carry out this intent. This does not mean that the court can go outside the law itself, as, for example, to the record of the debate contained in the Congressional Record, to inquire into the intent of the legislature. The intent is to be discovered from the use of the words, the general purpose of the act, and from general principles of justice. While the law will not be construed strictly in favor of the taxpayer, as in the case of the laws relating to crimes, the benefit of any doubt as to the true meaning of a clause will be given to the taxpayer. The courts, of course, will rely on their own previous opinions when applicable, and will even give weight to the rulings of the Treasury Department, especially to those of long standing. The court, however, will always make an independent inquiry into the meaning of the law and will not decide in favor of a Treasury Department ruling which seems clearly contrary to the meaning of the law.

Taxes in outlying possessions.—Under the 1916 law the tax applies to the "United States," which is construed, for the purpose of the Income Tax, to include "the United States, any Territory, the District of Columbia, Porto Rico, and the Philippine Islands."

A resident of Porto Rico or the Philippine Islands would pay the taxes in those Territories, the internal revenue officers of which are given power to administer the law. Under the amendments contained in the Income Tax law of October 3, 1917, however, the several legislatures of those Territories are given the right to amend or repeal the Income Tax law within their own boundaries, and inquiry must be made therefore in the respective territories concerning what action, if any, has been taken by the local legislatures and administrative officers. Residents of the United States, however, part of whose income is derived from investments in those Territories, should include such income in

their returns and pay their taxes in the district wherein they reside.

The collection of the income and excess profits taxes.—The actual collection of the taxes is handled by the local collectors of internal revenue. For the purpose of tax collection, the United States is divided into 64 collection districts, each district being in charge of a collector of internal revenue. A list of the districts, with the names and addresses of collectors, will be found in the appendix.

Every person, firm or corporation required by law to file a return for any tax should file the return within the required time with the collector of internal revenue for the district in which they reside or have their principal place of business.

When a return is filed it is examined to see if it is properly prepared. If there are any gross errors the return may be sent back to be corrected. If a new return is made out, the old return, showing the date of its receipt, should also be returned to the collector to avert the possibility of the assessment of a penalty for failure to file the return on time. The amount of tax is then calculated and the returns are listed for assessment on what is known as the monthly list. The list and returns are forwarded to the Commissioner of Internal Revenue, who charges the local collector with the total amount of the tax, as shown by the list, which is then returned to the collector. Upon receipt of this list the collector sends each person or organization a bill for the amount of tax assessed (Form 647 or Form 17). The tax must be paid by a date fixed by law or within 10 days after the receipt of the first notice and demand (Form 17).

Penalties.—The law imposes various penalties for failure to make returns, and for failure to pay the tax.

For failure to file a return on time, except in case of sickness or accident, a penalty will be imposed of 50

per cent in addition to the amount of the tax. If a return is voluntarily made, without notice from the collector, and it is shown that the failure to file was due to a reasonable cause and not to wilful neglect, the penalty will not be imposed.

If a false or fraudulent return is made, a penalty of 100 per cent of the amount of tax will be imposed. This penalty of 100 per cent is always computed upon the amount actually due. In the case of special taxes, the basis on which the 100 per cent penalty is computed may be one or more of the taxable occupations of the taxpayer not disclosed in his false return, or an additional amount for the same occupation not disclosed by the false return.

For failure to file the proper returns on or before March 1 of each year an individual or an agent is liable to a specific penalty of from $20 to $1,000, but the 50 per cent penalties for failure to make return will not be assessed against delinquent withholding agents. Any individual or any officer of a corporation required to make or verify any return who makes an intentionally fraudulent return is guilty of a misdemeanor and is subject to a fine not exceeding $2,000 or imprisonment, or both, in the discretion of the court, and must also pay the cost of the proceedings.

If any corporation refuses or neglects to file a return in time, or makes a false or fraudulent return, it is liable to a specific penalty of not exceeding $10,000.

On any taxes remaining unpaid for 10 days after notice and demand by the collector there is added a penalty of 5 per cent of the amount of the tax, and interest at the rate of 1 per cent a month until it is paid. If a claim for abatement is made the 5 per cent penalty is stayed until the claim is rejected.

More than one of these penalties may be incurred in connection with the same return. If all the facts causing the different penalties are known all the penalties

will be assessed at the same time, but the assessing of only one penalty is no bar to the assessing of another penalty for the same return at a future date.

Checking up taxpayers.—Section 3172 of the Revised Statutes provides that "every collector shall, from time to time, cause his deputies to proceed through every port of his district and inquire after and concerning all persons who are liable to pay any internal revenue tax, and all persons owning or having the care and management of any objects liable to pay any tax, and to make a list of such persons and enumerate said objects."

Various methods are used by the collectors in compliance with this provision of the law as it is applied to the Inheritance Income Tax. Under the 1916 law, with exemptions of $3,000 and $4,000, the local collectors would make up lists of all purchasers of automobiles, etc., of all persons occupying apartments renting for over $1,000 a year, and other similar lists of people who would seem to be having an income of $3,000.

With the exemption reduced to $1,000 and $2,000, the work of the collectors will be more difficult. The new provision, however, regarding information at the source, will undoubtedly furnish a check on almost every person liable to the tax.

When a collector has information indicating that any person in his district has neglected to file a return he may send out the following form letter:

SIR:

This office is in possession of information which indicates that for the taxable period January 1 to December 31, 1917, you were in receipt of an income subject to the income tax.

The records of this office do not show that you have made and filed a return of income for this taxable period.

Under the authority of section 3173, Revised Statutes of the United States, as amended and made part of the Income Tax Law, you are requested and required to make and file, within ten days after the date of this letter, a return of your income for the period January 1, 1917, to De-

cember 31, 1917, inclusive, in accordance with Income Tax Form 1040, two copies of which are herewith enclosed.

Should you fail to make and file a return of income within the time herein limited it is made the duty of the Collector "to summon such person, or any other person having possession, custody or care of books of account relating to the business of such person, or any other person he may deem proper, to appear before him and produce such books, at a time and place named in the summons, and to give testimony or answer interrogatories, under oath, respecting any objects liable to tax or the returns thereof."

Paragraph K of the Income Tax Law confers jurisdiction upon the district courts of the United States for the district within which any person summoned under this section to appear to testify or to produce books shall reside, to compel attendance, production of books, and testimony by appropriate process.

Respectfully,

....

(Signature)

Collector.

Right of collector to make returns.—Where no return is filed or where the return is false or fraudulent the collector has the right to examine the books and records of the individual or corporation and make up a return from such information as he can secure. Such a return is held prima facie good for the purpose of assessment and for all legal purposes.

The United States District Courts are given jurisdiction on any suits arising under the Income Tax Law, and have the power to compel the attendance of witnesses and the production of books and testimony.

Second notice of tax assessment.—In the event of failure to pay the tax on or before due date a second notice is sent to the taxpayer immediately following the due date. This notice, which is very similar to the first notice, reads as follows:

Having failed to make payment of taxes set forth opposite, within the prescribed time of notice and demand on Form 17, there has attached a 5 per cent penalty on said tax and interest at 1 per cent per month from date given below, demand is made for said taxes, penalty, and such interest as may accrue before payment. If payment is not made within 10 days from the above date, it will be my duty to collect the same with costs by seizure and sale of property.

Date interest began...............

....

Collector of Internal Revenue.

Receipts for payment of taxes.—In the case of stamp taxes, the placing of the stamp on the document or commodity taxed is sufficient evidence of payment.

On all other taxes the collector is required to give an official receipt. This official receipt is the only receipt that will be accepted by the Department as evidence of the payment of the tax.

Deputy collectors may sign personal receipts or voucher receipts, but these are merely for the convenience of the taxpayer, and are not official receipts.

Auditing and investigation of return.—After the returns are checked against the assessment lists at Washington they are turned over to the Chief Revenue Officer for auditing. The returns are checked first for mathematical accuracy, second for compliance with the law, and third for evidence of fraud. Any mathematical errors on the return are corrected, and if necessary an additional assessment is made.

Where the return does not give all the required information or where there is evidence of fraud an abstract of the return is made and turned over to the supervisor of the field force of the district in which the return was filed, for investigation. This field force of investigators now numbers about 1,100 men, but it is being rapidly increased, and by the middle of 1918 will no doubt number about 2,500 men.

It is impossible to say just what items will cause an investigation of a return. As a general rule, the most frequently investigated items are expenses, losses, bad debts and depreciation. The examining officer has the right to examine the books and records of the person or corporation making the report to determine their accuracy. On the basis of his investigation he either reports the original return correct or makes recommendation for assessment of additional tax, as disclosed to be due. The salaries of these inspectors are in no way dependent upon the amount of additional tax

assessed as a result of their investigations. The results show that there are very few cases of intentional fraud, and that most incorrect returns are due to a misunderstanding of the requirements of the Treasury Department.

Where a revised return or assessment of tax is made because the former one is held to be false or fraudulent the taxpayer cannot question the new assessment unless he proves that the original return was correct. This provision also applies in cases of additional assessments made as a result of examinations of the taxpayers' books of account which disclose additional tax due.

Claims for refund and abatement of taxes.—All taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in any manner wrongfully collected, will be refunded to the taxpayer if they have already been paid, or abated, if payment has not been made.

Claims for the refunding of assessed taxes and penalties must be made out upon Form 46, prescribed for that purpose. The burden of proof rests upon the claimant. All the facts relied upon in support of the claim should be clearly set forth under oath. The claim should be still further supported by the attachment thereto of the receipt or stamp issued in the payment of the tax. Claims can now be made for refund of taxes paid under the act of August 5, 1909, act of October 3, 1913, and act of September 8, 1916, if the question involves a review of the return, notwithstanding the two-years' "Statute of Limitations" under the provisions of section 3228 of the Revised Statutes of the United States. Such claims should be filed with the collector of internal revenue in the district wherein the tax was paid for which claim for refund is made.

A claim for abatement of tax must be filed on Form 47. The claim must be sustained by the affidavits of

the party against whom the tax was assessed or of other parties cognizant of the facts, and must be accompanied by the affidavit of the deputy collector and the collector of the division in which the claim arose.

Suit to restrain assessment or collection of taxes.—Section 3224 of the Revised Statutes provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court."

If an assessment is made which the taxpayer believes is excessive he may file a claim for abatement. If that is refused he must pay the tax. He may then enter a claim for a refund, and if that is refused his only recourse is the courts.

Suits for recovery of taxes wrongfully collected.—No suit will be maintained in any court for the recovery of taxes wrongfully collected unless an appeal has been made to the Commissioner of Internal Revenue in the manner explained above, and a decision obtained. If, however, the decision is delayed more than six months from the date of the appeal suit may be brought without awaiting the decision of the Commissioner.

Compromises.—The Commissioner of Internal Revenue is permitted to compromise any civil or criminal case arising under the internal revenue laws before commencing suit thereon, and also after the instituting of suit by the Government.

Secrecy of returns.—The law provides that "it shall be unlawful for any collector, deputy collector, agent, clerk or other officer or employee of the United States to divulge or to make known in any manner not provided by law to any person the operations, style of work, or apparatus of any manufacturer or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return, or to permit any income return or copy thereof or any book containing any ab-

stract or particulars thereof to be seen or examined by any person except as provided by law, and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return or any part thereof or source of income profits, losses, or expenditures appearing in any income return. An offense against the provision is a misdemeanor and is punishable by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court, and if the offender is an officer or employee of the United States he will be dismissed from office or discharged from employment.

Use of returns for public records.—The following rules and regulations for the inspection of returns have been made by the Secretary of the Treasury, with the approval of the President, and published as T. D. 2016:

1. The return of every individual and of every corporation, joint stock company or association, and every insurance company, whether foreign or domestic, shall be open to the inspection of the proper officers and employees of the Treasury Department. Returns of individuals shall not be subject to inspection by any one except the proper officers and employees of the Treasury Department.

2. Where access to any return of any corporation is desired by an officer or employee of any other department of the Government, an application for permission to inspect such return, setting out the reasons therefor, shall be made in writing, signed by the head of the executive department in which such officer or employee is employed, and transmitted to the Secretary of the Treasury. If the return of a corporation is desired to be used in any legal proceedings other than those to which the United States is a party, or to be used in any manner by which any information contained in the return could be made public, the application for permission to inspect such return or to furnish a certified copy thereof shall be referred to the Secretary of the Treasury.

3. All returns, whether of persons or of corporations, joint stock companies or associations, or insurance companies, may be furnished, upon approval of the Secretary of the Treasury, for use, either in the original or by certified copies thereof, in any legal proceedings before any United States grand jury or in the trial of any cause to which both the United States and the person or corporation or association rendering the return are parties either as plaintiff or defendant, and in the prosecution or defense or trial of which action, or proceeding before a grand jury, such return would constitute material evidence, but in any case arising in the collection of the income tax, the Commissioner of Internal Revenue may fur-

nish for use to the proper officer either the original or certified copies of returns without the approval of the Secretary of the Treasury. In all cases where the use of the original return is necessary, it shall be placed in evidence by the Commissioner of Internal Revenue or by some officer of the Bureau of Internal Revenue designated by him for that purpose, and after such original return has been placed in evidence it shall be returned to the files in the office of the Commissioner of Internal Revenue at Washington, D. C.

4. The Secretary of the Treasury, at his discretion, upon application to him made, setting forth what constitutes a proper showing of cause, may permit inspection of the return, of any corporation, by any bona-fide stockholder in such corporation. The person desiring to inspect such return shall make application, in writing, to the Secretary of the Treasury, setting forth the reasons why he should be permitted to make such inspection, and shall attach to his application a certificate signed by the president, or other principal officer, of such corporation, countersigned by the secretary, under the corporate seal of the company, that he is a bona-fide stockholder in said company. (Where this certificate cannot be secured, other evidence will be considered by the Secretary of the Treasury to determine the fact whether or not the applicant is a bona-fide stockholder and, therefore, entitled to inspect the return made by such company.) Upon receipt of such application the corporation whose return it is desired to inspect shall be notified of the facts and shall be given opportunity to state whether any legitimate reason exists for refusing permission to make such inspection. The privilege of inspecting the return of any corporation is personal to the stockholders, and the permission granted by the Secretary to a stockholder to make such inspection cannot be delegated to any other person.

5. The returns of the following corporations shall be open to the inspection of any person upon written application to the Secretary of the Treasury, which application shall set forth briefly and succinctly all facts necessary to enable the Secretary to act upon the request:

(a) The returns of all companies whose stock is listed upon any duly organized and recognized stock exchange within the United States, for the purpose of having its shares dealt in by the public generally.

(b) All corporations whose stock is advertised in the press or offered to the public by the corporation itself for sale. In case of doubt as to whether any company falls within the classification above, the person desiring to see such return should make application, supported by advertisements, prospectus, or such other evidence as he may deem proper to establish the fact that the stock of such corporation is offered for general public sale.

Returns can be inspected only in the office of the Commissioner of Internal Revenue, in Washington, D. C. In no case shall any collector, or any other Internal Revenue officer outside of the Treasury Department in Washington, permit to be inspected any returns or furnish any information whatsoever relative to any return or any information secured by him in his official capacity relating to such

return, except in answer to a proper subpœna, in a case to which the United States is a party.

6. Returns of individuals shall not be open to the inspection of any person other than the proper officers and employees of the Treasury Department or person réndering the same, and are under no conditions to be made public, except where such publicity shall result through the use of such returns in any legal proceedings in which the United States is a party.

7. Upon request of the governor of a State imposing a general income tax, the proper officer of such State, to be designated by name and official position by the Governor of such State, in his application to the Secretary of the Treasury, may have access to the returns or to abstracts thereof showing the name and income of each corporation, joint stock company or association, or insurance company, at such times and such manner as the Secretary of the Treasury may prescribe. Such application shall be in writing, addressed to the Secretary of the Treasury, and shall show (first) that the State, whose governor makes the request, imposes a general income tax; (second) the name and address of each corporation, etc., to which access is desired; (third) why permission to inspect the returns of the corporations, etc., named in the request is desired; and (fourth) what officer or officers are designated to make the desired inspection, giving their names and official designations. Such request must be signed by the governor of the State and sealed with the seal thereof, and shall be transmitted to the Secretary of the Treasury for his consideration and action thereon.

No provision is made in the law for furnishing a copy of any return to any person or corporation, and no copy of any return will be furnished to any other than the person or corporation making the return, or their duly constituted attorney, except as hereinbefore authorized.

The provisions herein contained shall be effective on and after the 1st day of September, 1914.

W. G. McAdoo,
Secretary of the Treasury.

Approved:
Woodrow Wilson,
The White House, July 28, 1914.

(T. D. 2016.)

CHAPTER III

INDIVIDUAL INCOME TAX

Income Tax laws now in effect.—In February, 1913, the Sixteenth Amendment to the Constitution of the United States became effective. This amendment gave to Congress the power "to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States." In October, 1913, the first income tax was repealed and a new law substituted. This law is still in effect. On October 3, 1917, Congress passed the so-called War Revenue Law. This act amended the 1916 law in a number of important matters, and among other things imposed an additional "War Income Tax." Income for the calendar year of 1917 is therefore subject to the combined taxes imposed by the 1916 and the 1917 laws.

The exemptions allowed under the "War Income" Act are considerably lower than under the 1916 law, and it is estimated by the Treasury Department that 7,000,000 more people will pay the income tax under the new law than paid under the old law.

WHO MUST FILE REPORTS

Returns required.—Under the law as it is in effect for the year 1917 returns[1] of net income will be required of:

[1] The word "return" frequently is used in discussion of the income tax. No definition is given since the word has come to have a fairly well defined meaning in connection with the administration of tax laws. A "return" is simply the sworn, signed statement of a person, which is to be filed or "returned" to the proper tax office that there may be calculated the amount of tax that the person making the return will be obliged to pay.

1. Every individual, a citizen or resident of the United States, having a net income of:
   (a) $1,000 or over if unmarried, or married but not living with husband or wife.[1]
   (b) $2,000 or over if married and living with husband or wife.[2] If the husband and wife have separate incomes, each may report their income separately, or they may report their combined income on one return. In the latter event, the normal[3] tax is computed upon the joint income, but the super-tax is computed only upon the separate income of each. If the income of husband and wife together, or of husband, wife and minor children together, or of parent and minor children together exceeds $5,000, a separate report should be filed for the income of each. Otherwise, it is possible that the super-tax may be imposed on the joint income, whereas, the intention of the law is that the super-taxes be imposed only on the separate incomes.
2. Every non-resident alien having a net income from sources within the United States regardless of the amount or character of such net income.[4]

[1] In so far as the exemption from filing a return is concerned the Treasury Department treats a married person not living with husband or wife as if unmarried. The fact that an individual is treated as unmarried for the purpose of filing a return does not prevent such individual from taking advantage of the specific exemption of $2,000. There will undoubtedly be a number of cases where a return will be required but where no tax will be levied.

[2] No return of net income will be required of husband and wife living together during the year 1917 and subsequent years when the separate income of either exceeds $1,000 but the combined income does not equal or exceed $2,000.

[3] See Chapter on Rate of Tax, p. 126.

[4] From the rulings of the Department it might seem that no returns will be required of non-resident aliens having an income from sources

No returns, however, are required of foreign governments receiving income from investments in the United States in stocks, bonds or other domestic securities owned by such foreign governments, or from interest on deposits in banks in the United States belonging to foreign governments.

3. Every executor or administrator for:

(a) The net income of a decedent from January 1 to the date of his death, provided such income was $1,000 or over (or $2,000 or over in case the decedent was married and living with husband or wife at time of death).

(b) Net income received by the estate during period of administration or settlement, the income of which is distributed annually to beneficiaries, provided the amount paid to any one beneficiary equals $1,000 or $2,000 according to the marital status of the beneficiary, and where more than one beneficiary is shown on the return the lowest exemption would determine the liability for the purpose of making a return.

(c) Income of any trust estate not distributed, provided it is $1,000 or over. It should be

within the United States of less than $3,000. This mistake is caused by the fact that under the law of September 8, 1916, non-resident aliens were not required to file a return unless their income was $3,000 or over. They were also allowed the specific exemption of $3,000 or $4,000. By the amendments of October 3, 1917, the right to the specific exemption was taken away and for the year 1917 non-resident aliens are therefore taxed on their entire taxable net income. It is true that the normal tax of 2 per cent. on all income accruing in the United States to non-resident aliens is to be withheld at the source, but there are any number of circumstances where this withholding is impracticable. To protect itself, the Treasury Department will require returns of every non-resident alien for his entire taxable income derived from all sources in the United States, corporate or otherwise, regardless of the character or amount of such income.

noted, however, that no exemption is allowed to estates of non-resident alien decedents.

4. Fiduciaries acting for minors or other incompetents, provided the net income is $1,000 or $2,000, according to their marital status.

Definition of "every individual."—"Every individual" means every person of lawful age, regardless of sex. The income of a dependent child under the age of 18 should be included with that of the head of the family, who is allowed an additional deduction for every child so dependent (see specific exemption, discussed later), unless such income was derived from a separate estate under control of a guardian, trustee or other fiduciary. Income of a minor or incompetent, derived from a separate estate, must be reported by his legal representative.

The status of an individual as to whether such individual must file a return when income equals $1,000 but is not in excess of $2,000 is determined by the status as of the end of the year for which the return is filed.

It must be borne in mind that the exemption from filing a return is not on the same basis as the specific exemption allowed from the normal tax. To illustrate: *A*, who is supporting a crippled brother, has an income of $1,500. As the head of a family (defined on p. 130), he is allowed a specific exemption of $2,000. He must, nevertheless, file a return, because his income is in excess of $1,000 and he does not come within the classification of "married and living with husband or wife."

Payment of income taxes to foreign countries does not exempt from tax.—Any individual subject to the income tax is not relieved from liability to the tax by reason of the fact that such individual is also subject to the income tax laws of other countries.

Meaning of "State" and "United States."—The 1916 Income Tax law provides: "That the word "State" or "United States," when used in this title, shall be construed to include any territory, the District of Columbia, Porto Rico, and the Philippine Islands, when such construction is necessary to carry out its provisions."

The act of October 3, 1917, states distinctly that its provisions do not extend to Porto Rico and the Philippine Islands.

Residents of the Philippine Islands and Porto Rico are therefore subject to the tax only at the rates imposed by the 1916 law.

Citizenship.—Citizens born in the United States, even though they have resided abroad for a number of years, will for taxing purposes be considered citizens of the United States, unless they have definitely renounced their citizenship. But under the provisions of an act dated March 2, 1907 (sec. 2), a naturalized citizen raises the presumption of expatriation by his protracted residence abroad. The Treasury Department, however, has held that "an individual's native or naturalized status remains unless changed by affirmative action or forfeited by an overt act." Thus, cases may arise where an individual will be held by the State Department to have expatriated himself by reason of his protracted residence abroad and at the same time will be held by the Treasury Department as subject to the income tax as a citizen of the United States.

It will be noted that if a woman marries a foreigner she takes the nationality of her husband.

When is an alien "resident" in the United States.—"Residence" is held to be "that place where a man has his true, fixed and permanent home and principal establishment and to which, whenever he is absent, he has the intention of returning; and indicates permanency of occupation as distinct from lodging or boarding, or temporary occupation."

Where, for business purposes or otherwise, an alien is permanently located in the United States; has there his principal business establishment and is there permanently occupied or employed, even though his domicile may be without the United States, he will be considered a resident of the United States.

But aliens who are physically present in the United States, and only temporarily resident or employed therein (as for a season or other similarly definite term, and with the expectation or intention of leaving the United States upon the termination of employment or accomplishment of the purpose which necessitated their presence in the United States), are not considered "residents" of the United States for income tax purposes.

Practical effect of distinction between "residents and citizens of the United States" and "non-resident aliens."—A person who is considered a citizen or resident of the United States is subject to the income tax at the rates provided in both the September 8, 1916, act and the October 3, 1917, act, and must report all income from all sources within or without the United States. Such individuals, however, are allowed the specific exemptions of $3,000 or $4,000 as provided in the 1916 law and of $1,000 or $2,000 as provided in the 1917 law.

A person who is a non-resident alien is subject to the 2 per cent normal tax of the 1916 law, but not to the 2 per cent normal tax imposed by the 1917 law, but he is subject to the super-tax imposed by both laws. However, he need report only such income as arises from sources within the United States. Such individuals are not entitled to any personal exemption. That is to say, they are taxed on their *entire* net income arising from sources within the United States.

What is net income?—In order to determine whether or not an income tax return should be filed, the net income must first be ascertained, by deducting from the

gross income (not including exempt items, which need not be reported), the following items, subject to the regulations of the Treasury Department:

1. Business expenses.
2. Interest paid.
3. Taxes paid.
4. Losses incurred.
5. Bad debts.
6. Depreciation.

Summary outline.—The scheme of the Individual Income Tax law and of its administration will possibly be clearer to the reader after he has studied carefully the following outline, which is given partly by way of summary of what has already been said and partly in anticipation of questions yet to be taken up.

Individuals:

- A. Those who file no report.
  1. Unmarried, or married but not living with spouse, and having income of less than $1,000.
  2. Married and living with spouse but having joint income (of individual and spouse) of less than $2,000.
- B. Those who file a report.
  1. Unmarried, or married but not living with spouse and having income of $1,000 or more.
  2. Married and living with spouse and having joint income of $2,000 or more.
  3. Non-resident aliens, regardless of amount of income.

Items of Income:

- A. Exempt items—those which should not be re-reported.
- B. Partially exempt items—those which must be reported but which may be subject to only a

part or parts of the tax. The total tax payable for the year 1917 may really be divided into four parts: (1) the normal tax of the 1916 law; (2) the super-tax of the 1916 law; (3) the normal tax of the 1917 law; (4) the super-tax of the 1917 law.

C. Fully taxable items—those items which are to be reported and are subject to all the taxes.

EXEMPT INCOME—NOT REPORTABLE

Income exempt from taxation and which may be omitted from the income tax reports.—The Income Tax law, sec. 4, exempts the following items of income:

1. (a) The proceeds of life insurance policies paid to individual beneficiaries upon the death of the insured; (b) the amount received by the insured as a return of a premium or of premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

2. The value of property acquired by gift, bequest, devise or descent. But the income from such property must be reported as income.

3. Interest upon the obligation of a State or any political subdivision thereof or upon the obligations of the United States (but in the case of obligations of the United States issued after September 1, 1917, only if and to the extent provided in the act authorizing the issue thereof) or its possessions, or securities issued under the provisions of the Federal Farm Loan act of July 17, 1916.

4. The compensation of the present President of the United States during the term for which he has been elected.

5. The compensation of the judges of the Supreme and inferior courts of the United States in office as of October 3, 1917.

6. The compensation of all officers and employees of a State, or any political subdivision thereof, except when such compensation is paid by the United States Government.

Proceeds of life insurance policies.—When the proceeds of insurance policies are paid to a beneficiary other than the insured these proceeds are entirely exempt. But where the amount returned on a life insurance, endowment or annuity contract is paid to the person making the contract, either upon the maturity or surrender of the contract, the amount by which the sum received exceeds the sum paid is (according to the ruling of the Treasury Department) income, and should be reported as such. To illustrate: *A* takes out a twenty-year endowment policy, the premium of which is $40 a year, payable to his wife upon his death if it should occur prior to the termination of the twenty-year period. He received dividends on his policy averaging about $2 a year. Should he die before the expiration of the twenty-year period, his wife is not required to include the amount received ($1,000) as income. If he lives to collect the $1,000 he must return as income the difference between the amount received, $1,000, and the amount paid in, [20 × $38 ($40 — $2)], $760, or $240.

Annuities.—Where annuities are purchased by the annuitant for a lump sum the same rule holds. So much of the annuities paid to the annuitant as represents payments made by him on an annuity contract and returned to him is not to be included as income of the annuitant. Any increment on the purchase price of an annuity is taxable income. To illustrate: An annuity of $3,500 is purchased for the lump sum of $45,000. The annuitant would not have to include the annuity in his income for the first twelve years of the contract, at the end of which time he would have collected $42,000. In the thirteenth year he would report as income $500

—the difference between the total amount received by him up to that time ($45,500) and the original amount which the annuity had cost him ($45,000). Thereafter he would include the entire annual payment of $3,500 as income.

Dividends from life insurance policies.—Dividends paid on life insurance policies that have not matured, whether such dividends are drawn in cash by the insured or applied to the reduction of the premium due, are not considered items of taxable income under the law, and should be excluded from a return of income.

Dividends from paid-up policies, however, are considered income to the recipient, and must be included in the annual return of income as such.

Value of property acquired by gift, bequest, devise or descent is exempt.—While the value of property acquired by gift is not subject to the income tax, all gains, profits, or income derived therefrom are subject to the tax, and if the property so acquired is subsequently sold at a price greater than the appraised value at the time the property was acquired by gift, if acquired subsequent to March 1, 1913, the gain in value is held to be income and is subject to the tax. If the property was acquired by gift prior to March 1, 1913, and sold thereafter, the gain, if any, is the difference between the market value March 1, 1913, and the selling price. Any increment in the value of the property prior to March 1, 1913, need not be reported and is exempt from tax.

Meaning of "Political subdivision of a State."—The law exempts from the tax interest on obligations of a State or any political subdivision thereof. The term "political subdivision" includes special assessment districts or divisions of a State created by the proper authority of the State acting within its constitutional powers and under its general laws, for the purpose of carrying out a portion of those functions of the State which by long

usage and inherent necessities of government have always been regarded as public. This definition is very broad and includes cities, towns, villages, school districts, road districts, levee districts and other special assessment districts created under the laws of the State for public purposes, such as the improvement of streets and highways, the provision of sewerage, gas and light, and the reclamation, drainage or irrigation of bodies of land within such special assessment districts, provided such districts are for public use.

But where a municipality purchases a public utility subject to a mortgage, the mortgage retains its original character, even though the municipality assumes the mortgage and pays the interest thereon. The indebtedness secured by such a mortgage is not an obligation of a "political subdivision" of a State, and the interest therefrom is not exempt from tax.

Exemption of income on bonds of the United States.—Interest upon the obligations of the United States or its possessions issued prior to September 1, 1917, is entirely exempt from the tax, and need not be included in the return of income.

Interest on any obligations issued subsequent to that date is exempt only if such exemption is provided for in the law authorizing their issue, and then only to the extent authorized.

Interest on bonds of the second Liberty Loan, on Treasury Certificates of Indebtedness and on the new War Savings Certificates issued under the act of September 24, 1917, should be included in the return to the extent that such interest is on a principal amount of such securities in excess of $5,000. This is because the interest is exempt only from the normal tax, and from the super-tax to the extent of the interest on $5,000 par value of the bonds or certificates.

Interest on the first Liberty Loan bonds, i.e., the 3½s, is exempt and need not be reported.

Compensation of judges of U. S. Supreme Court and inferior courts exempt.—The exemption of the compensation of the judges of the Supreme and other courts of the United States (i.e., Federal Courts), applies only to those in office prior to October 4, 1917. The salary of all judges appointed subsequent to that date is subject to income tax.

Exemption of State officers and employees.—The compensation of all employees of a State or of any political subdivision thereof (for definition of political subdivision see p. 41, ante), are exempt. But when State employees are compensated by the United States, such income is taxable.

It must be borne in mind that an individual who enters into a contract with a State, or any political subdivision thereof, for the construction of a public highway or other public works, is held not to be an officer or employee of the State or political subdivision thereof. Therefore, the amounts received by him from the State or political subdivision thereof, under the terms of the contract, are not exempt from tax under the provisions of the Federal Income Tax law, and should be included in any return of annual net income which the contractor may be required to render. Of course, it follows that employees of such a contractor are not employees of a State or of any political subdivision thereof. They, too, must include the compensation received from the contractor in any return required.

Salaries of government officials of Porto Rico, the Philippine Islands and the District of Columbia.—Income of officials of Porto Rico, the Philippine Islands and the District of Columbia or any political subdivision thereof is not exempt from the tax, and must be included in the return filed.

INCOME TO BE REPORTED

Gross income.—The gross income of an individual includes all gains, profits and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid; or from professional vocations, business, trade, commerce, or sales; or from dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property; also from interest, rent, dividends, securities, or the transaction of any business caried on for gain or profit, or gains or profits and income derived from any source whatever.

Non-resident aliens.—But the non-resident alien need report only such income as arises from sources within the United States. The phrase "from sources within the United States" is very broad. It includes income from sales of goods to residents within the United States, royalties received on patents used in manufacturing goods in the United States, and interest on bonds and dividends on stock of domestic corporations owned by non-resident aliens, even though the securities themselves are physically located and payable outside of the United States.[1]

The fact that income is paid in the United States does not necessarily mean that the source of the income is in the United States. Interest on bonds and dividends on the stock of a foreign corporation, for example, even though paid in the United States, is not income from sources within the United States, and should not be included in the report filed by the non-resident alien.

Income earned prior to March 1, 1913, not taxable.—The intention of the Income Tax law is to tax all income earned by individuals subsequent to March 1, 1913. The general practice is to tax the income received in

[1] See also pp. 171, 172.

any year, at the rates in effect at the time the income is reported. Partnership profits, however, are required to be reported when earned, regardless of whether they are distributed or not. (See Partnership Income, page 71 post.) Where the income received is partly earned prior to March 1, 1913, and not received by the person making the return until the year 1917, the burden of showing what part of the income was actually earned prior to March 1, 1913, is upon the taxpayer.

Income earned in previous years.—Where the income which is reported in the year received was earned in a previous year or years, the question arises as to whether the income should be taxed at the rates in effect for the year in which it was earned or those in effect for the year in which it was reported. The answer is, that in such a case the individual must pay the tax at the rate in effect at the time the income is reported. The taxpayer, to be sure, has the privilege of reporting his income when earned, instead of when received, but the Department correctly holds that if he does not take advantage of this privilege he must pay the tax at the rates in effect at the time when the income is received and reported.

Dividends received from corporations are an exception to this rule. The taxpayer does not have any option as to the time of reporting such income. The income is not earned by him until received, though, as a matter of fact, the income represented by the dividends may have been earned by the corporation in a previous year. The Department, therefore, holds that dividends are taxable at the rates in effect in the year in which they were earned by the corporation. The burden of showing that the dividends were earned in years previous to that in which they were paid is, of course, upon the taxpayer, and it follows, therefore, that if the individual does not prove that the dividends were earned in previous years, they will be taxed at

the rates in effect in the year in which they are reported.[1]

In the case where an individual has been employed for the past three years at an annual salary of $5,000, but due to the financial condition of the employer he has received only $2,000 each year, and in 1917 he receives all his back salary, plus the regular salary of $5,000, the total amount received in 1917 salary must be then included as income, unless it had been reported in previous years on an accrual basis.

Income may be reported either when received or when earned.—Section 1 of the Income Tax law of September 8, 1916, as amended, provides that the tax shall be levied, assessed, collected, and paid annually "upon the entire net income received in the preceding calendar year from all sources." However, section 8, paragraph (g), further provides that, "any individual keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect his income, may, subject to regulations made by the Commissioner of Internal Revenue, and with the approval of the Secretary of the Treasury, make his return upon the basis upon which his accounts are kept, in which case the tax shall be computed upon his income as so returned."

Thus, if an amount of salary earned during the year was not received until some date subsequent to December 31st of that year, it need not be reported for the year in which it was earned, unless the individual has kept his accounts on an accrual basis in which he credited himself with that salary during the year in which it was earned. If the accrual basis of determining income is used one year, it must also be used the following year. For example: *A* is employed at a salary of $500 a month, payable on the 15th of each month. His salary is raised to $750 a month begin-

[1] See Dividends, p. 78.

ning the 15th of June, 1917. If he reported his 1916 income on the basis of cash received he will report for 1917 an income from salaries of $7,500. But if he reports his 1916 income on an accrual basis he will report for 1917 an income from salaries of $7,625.

Classification of gross income.—Gross income may be classified as arising from the following sources (each item is explained in full in the following pages):

1. Salaries, wages and commissions.
2. Income from professions and vocations.
3. Profits from business, trade, and farm.
4. Profits from sales or dealings in property, whether real or personal.
5. Royalties from mines, oil wells, patents, franchises or other legalized privileges.
6. Rents.
7. Interest on notes, mortgages, bank deposits, other than included in class 8 or 9, below.
8. Interest on bonds, mortgages, or deeds of trust, or other similar obligations of domestic corporations, joint-stock companies or associations, and insurance companies.
9. Income of fiduciaries in their trust capacity (except dividends from domestic corporations and interest on second Liberty Bonds).
10. Partnership gains or profits (excluding dividends and interest on second Liberty Bonds).
11. Interest and dividends upon securities of foreign corporations.
12. Miscellaneous income or income from other sources.
13. Dividends on stocks and interest on second Liberty Bonds.
    - (a) Received directly.
    - (b) Received through partnership.
    - (c) Received through fiduciaries.

SALARIES, WAGES AND COMMISSIONS

Salaries, wages and commissions.—Our first subdivision of gross income is salaries, wages and commissions and other compensation of the individual during the year. As has been indicated, salaries of officers or employees of the State or of any political subdivision of the State and of certain federal officials are exempt from taxation and need not be included in the report.

The compensation may be in cash or its equivalent.—The compensation of an individual need not be money; it may take the form of living quarters, light, board, use of special privileges, etc. The value of such extra compensation should be calculated or determined and included in the return as part of the salary or compensation. The Treasury Department has stated that where an individual is provided with living quarters in addition to his salary, the rental value of the living quarters is regarded as compensation subject to the income tax.

In some cases it is difficult to determine whether or not the granting of special privileges is part of the compensation. Furnishing a salesman with the use of a car for business purposes would not be compensation, even though he is permitted to use the car for personal purposes. The test of whether any particular item is received as compensation and therefore returnable in the report is this: "Is the item in lieu of some non-deductible expense, such as ordinary living expenses, that would otherwise be incurred?" If it is in lieu of such non-deductible expense it should be included as income to the extent of the expense that would otherwise be incurred. For example: *A* is an employee living in a suburban town. Commutation to his place of business amounts to $100 a year. If *A* is given a pass over a railroad or is furnished with an automobile to go to and come from his business, he should report

the pass or use of the automobile as income to the extent of $100.

Quarters, mileage and expense of government officers and employees.—The Treasury Department has issued the following instructions to government officers and employees:

"When quarters are furnished of a less number of rooms than the number allowed by law, the money equivalent only of the number of rooms actually assigned shall be returned as income. When quarters are furnished of a greater number of rooms than the number allowed by law, it is to be assumed that the excess number is assigned for the convenience of the Government, and the money equivalent only of the number of rooms allowed by law shall be returned as income."

Heat and light.—Amounts received by, or paid for, an officer for heat and light shall be returned as income. "This includes the money equivalent, as fixed by the Government, of heat and light furnished to an officer occupying public quarters (for residence purposes)."

Mileage.—The difference between the amount received as mileage and the amount of actual necessary expenses incurred on a journey is to be returned as income. The actual expenses to be deducted by the individual before ascertaining his gain, profit, or income on account of mileage are the expenses for which reimbursement would be made by the government if he had traveled on an actual expense basis instead of on a mileage basis.

Reimbursement for actual expenses.—Amounts received from the government to reimburse the individual for subsistence and other items of actual expenses incurred while absent on business for the government are not required to be reported as income.

The difference between the amount received as a per diem allowance and the amount of actual necessary ex-

penses incurred on a journey must be reported as income.

Voluntary offerings received by clergymen should be considered as income.—Easter offerings, and fees received by clergymen for funerals, masses, marriages, baptisms, etc., are considered income subject to tax under the provisions of the Income Tax law, and must be reported. Christmas gifts, however, are not considered income within the meaning of the law and should not be included in a return. The theory probably is that all income except the Christmas gifts are earnings, while the Christmas gifts are in the nature of gratuities.

Compensation of the trustee of any estate should be returned as income for the year in which received.—If the amount due the trustee of any estate as compensation for his services over a period of years is not determined until the trust is terminated, the amount the trustee is allowed should be return in full, as income for the year in which it is paid. It should not be prorated over the length of time during which he served as trustee. But if the trustee can show that part of this fee has been definitely earned prior to March 1, 1913, that part of the fee will be exempt from the tax and need not be reported. This rule also applies to administrators and executors of an estate.

Expense allowances.—Where an individual receives, in addition to his salary or commissions, an allowance for traveling or other expenses, there should be included as income any difference between the allowance and the amount actually paid for these expenses.

The entire allowance may be included as income under the heading miscellaneous income, and the amount of expenses actually paid may be included in the deductions as necessary expenses, or simply the difference may be reported.

Salaries paid by exempt organizations are not exempt from the income tax.—Salaries paid by corporations,

which have been held to be exempt from the income tax, are subject to the income tax and should be returned as income by the individuals receiving them. For example, the salary of an individual employed by a charitable institution would not be exempt, though he is employed by an exempt organization.

Bonuses.—If special payment is made to an employee and is a gratuity or voluntary payment, for which no service is rendered, the amount so paid may be considered as a gift and need not be reported as income received. However, any bonus or other item of compensation paid to an employee in addition to his regular salary or wages as additional compensation for services actually rendered, as a reward for past endeavors, or as a stimulus to further zeal and enthusiasm in the discharge of his duties, is held to constitute taxable income, which should be reported under gross income in the employee's report. The circumstances under which such bonuses will be considered as being for services rendered are discussed more fully under allowable deductions for corporations. Wherever the employer may deduct from its income payments such as bonuses to employees, the employee must report the amount so received as income. Whenever the employer is not permitted to make such a deduction, the employee need not report the amount received. Christmas remembrances, anniversary gifts, etc., from an employer to an employee do not constitute such items as are considered taxable income, and need not be reported as income by the employee.

Commissions received should be reported as income.—Commissions received by salesmen are income and must be reported in the tax return of the salesman.

Commissions received on renewal premiums for insurance are income when received, and must be reported in the period in which they are received. It follows that a commission retained by a life insurance agent on

his own life insurance policy is income accruing to the agent, and must be included in his personal return of income.

Professional and vocational fees.—The services of a professional man are usually of such a nature as to be compensated by fees, or else of such a nature that no portion of the amount becomes due until the service is completed. In such a case the total amount of the compensation should be included in the return for the year in which the compensation is received. However, if the person making the report keeps his books on an accrual basis, he may report his income during the year in which the fee becomes due, even though it is not received until a later year. If subsequently any of these fees should prove uncollectible they may be deducted as bad debts in the year in which they are found uncollectible.

INCOME FROM BUSINESS, TRADE, OR FARM

Income from business, trade, or farm.—Our third subdivision of gross income is income received from business, trade, or farm.

If an individual is engaged in business or trade, conducted by him as a sole proprietor, or is the owner of a farm, he should report the total amount of cash received from the sale of merchandise or farm products for the calendar year, regardless of the time of closing of the books of his business.

If the individual keeps books upon the "accrual" basis he may report the amount of income "accrued," that is, earned but not yet received, instead of the amount of cash received. As against this he may deduct expenses incurred but not yet paid. If the income is reported on a cash basis, only the expenses actually paid may be deducted. The individual may not report his income on one basis and his expenses on another.

The cash received from the sale of merchandise is.

manifestly, not all profit, as neither the cost of the merchandise sold nor the expenses of the business have been considered. Accountants make a distinction between "gross" profit, which is the profit on the sale of merchandise, and "net" income, which is the profit after deducting the expenses of the business. The method of arriving at gross profit as used by accountants is illustrated by the following example:

Sales		$100,000
Inventory at the beginning of the year	$30,000	
Add purchases	90,000	
Total	$120,000	
Less inventory at end of year	$40,000	
Cost of goods sold		80,000
Gross profit on sales		$20,000

To ascertain the net income of this business, all other expenses, such as rent and labor, would be deducted from the gross profit on sales.

A form provided by the Treasury Department for the return of net income of individuals does not make this same distinction between gross profit and net income. The form provides for the stating of the total receipts as gross income and for the deduction of the various expenses, such as labor, rent, depreciation, etc. (all of which are covered in detail in a later section of this book). In the form, merchandise purchased is included among the expenses to be deducted, and no provision is made for stating the inventories at the beginning and at the end of the year. The amount of purchases, as may be seen by the illustration used above, does not of necessity represent the cost of the merchandise sold. The cost of merchandise sold is de-

termined by adding to the purchases the inventory at the beginning of the year and subtracting from the resulting figure the inventory at the end of the year. The net result of the transaction is to *add* to purchases the *decrease* in the inventory or to *subtract* from purchases the *increase* in the inventory. In the illustration just used the inventory at the end of the year shows an increase of $10,000. This means that of the $90,000 worth of merchandise purchased $10,000 was not sold. Deducting $10,000 from $90,000 we have the cost of the merchandise sold, or $80,000. In the form provided by the Treasury Department this latter figure should be stated as the merchandise purchased for resale, and should be deducted from the income of the business. See also Chapter on "Return and Computation of Tax," pp. 142 and 148.

Valuation of inventories.—The most usual and by far the most conservative business and accounting practice is to value inventories either at cost or at market, whichever is lower. In past years the attitude of the Treasury Department was not in accord with this practice, the Department insisting that the inventory of goods on hand be valued at cost, without regard to any change in market value. Recently, however, the position of the department has been modified so as to permit the valuation of inventories either at cost, or at cost or market, whichever is lower. The effect of this decision is discussed at length under Corporations in a later chapter.

Practical considerations governing inventory valuation.—While the new decision gives every merchant the option of deducting from his taxable income any loss he may have sustained due to a decrease in the market value of his merchandise or stock inventory, it is not always advisable for the merchant to exercise this option. It is well to bear in mind that the inventory figure reported at the end of one year must be used as

the inventory figure at the beginning of the following year. It is obvious, therefore, that any deduction from inventory valuations one year will be reflected in the following year's report, showing a corresponding increase in the income for the following year.

Therefore, it is often better (to save taxes in a subsequent year) to value inventories at cost, even when market value is lower. Obviously, this is true when, even if the inventories are valued at cost, no profit will be shown. The loss in inventory value can then be deducted in some subsequent year (when the goods are sold below the cost), and diminish the taxable profits for that year.

Moreover, if the profits are small this year, and much larger profits are anticipated the following year, it would probably save super-taxes, or excess profits taxes, in the later year to inventory the goods at cost this year.

But if the company cannot afford to pay much in taxes this year, it should inventory its goods at market price (if market price is lower than cost) so as to keep down its taxable profits this year. The effect of valuing inventories at market price, when that is lower than cost, is to decrease taxable profits for the current year, and practically to increase taxable profits for a future year.

From a taxpayer's standpoint it is often advisable to ask himself the following question: "Should I inventory my goods at market price, and thus save taxes this year, and take a risk on next year's taxes, or at cost, assuming my profits will be larger or the tax rate will be greater next year?"

Inventory at end of fiscal year.—If an individual's gross profit from business is determined by an inventory taken at the end of a fiscal year other than the calendar year he must estimate his profits for part of the year so as to comply with the Department's regu-

lations requiring him to report his gross income for the calendar year. To illustrate: *A* takes inventory and closes his books November 30. In making his return for the 10 taxable months of 1913,[1] he took nine-twelfths of his income for the fiscal year December 1, 1912, to November 30, 1913, and then estimated the profits for the remaining month (i.e., December, 1913) of the calendar year. The next year he took the difference between the income for the full fiscal year and the estimated income for the month of December, 1913, and then added a new estimated figure for December, 1914.

This method would be followed each year. In determining his gross income for the calendar year 1917, *A* would take his gross income for the fiscal year ending November 30, 1917, deduct the amount estimated in preparing the return, as the gross income for the month of December, 1916, and add to the resulting figure the estimated profit for the month of December, 1917.

Unless a perpetual inventory has been kept it will be necessary to estimate the gross income for the period between the close of the fiscal year and the close of the calendar year. The only reasonable method is to assume that the percentage of gross profit on sales for the period in question is the same as that actually determined for the preceding fiscal year.

Business need not be lawful.—The law of 1913 levied a tax on the gains from any lawful business. But the law of 1916 levies a tax on the gains from "business, trade, etc.," and the law does not specifically mention "lawful" businesses or trades. This would indicate that even though the business is of an unlawful nature the gains or profits should be reported.

Income from partnership.—Income from partnership interest in a business should not be reported under

[1] The income tax law of October 3, 1913, levied a tax on the income of individuals for the 10 months only, from March 1, 1913, to December 31, 1913, because the sixteenth amendment did not become effective until February 28, 1913.

this caption, inasmuch as it is reported under a separate caption. (See "Partnership Income," p. 71.)

Other income.—Income derived from the sale of or from dealings in property should be reported under this caption. If part of the business income is derived from interest, rents, royalties or dividends, such items should be shown under their respective captions.

Partially completed contracts.—If an individual enters into a contract in 1917 which will not be completed until 1918, and he is unable to determine what amount of gain or profit he will derive from the contract until its completion, any payments received thereon during 1917 need not be included as income for that year. Neither will the expenses incurred up to that time be included as a deduction. When the contract is completed in 1918, the net gain or profit derived therefrom should be reported in the return for that year.

Appreciation of book value of capital assets is not income.—Any appreciation in the value of assets due to reappraisal or adjustment and so recorded on the books of the individual or corporation is not income until such appreciation, as a result of a completed and closed transaction, has been converted into cash or its equivalent. Until any appreciation taken up on the books has been so realized, it will not be considered income. Hence, in the preparation of returns and in the examination of books for the purpose of verifying the same, mere book entries of appreciation in the value of capital assets will be disregarded. But in the event of the sale of the assets, the increase in whose value was previously taken up on the books, the profit or income to be reported (i.e., the taxable income) as a result of the sale will be determined upon the basis of the difference between the cost and the selling price of the assets; that is to say, in the case of a sale, book values will be ignored except as such book values represent the actual cost of the properties. For example,

an individual has a building which cost $100,000. During the year 1916 an entry was made raising the value to $200,000, thereby creating a book profit of $100,000. This profit should not be included in income for the year 1916. During 1917 the property was actually sold for $175,000. The books of the individual for 1917 show a loss of $25,000. For the purpose of the income tax he must disregard his book figures and go back to the original cost. The measure of profit is the difference between the original cost and the selling price, or $75,000, which should be reported as income for 1917. If the building was purchased prior to March 1, 1913, the measure of profit is the increase in fair market value above the fair market value as of March 1, 1913.

Non-resident aliens—method of determining profits from business in the United States.—A non-resident alien, as has been explained hereinbefore, is required to report only such income as arises from sources within the United States. If the business from which the non-resident alien derives profit is conducted entirely within the United States, there is no question but that the entire profits from the business should be included as income from within the United States.

The phrase "from sources within the United States" is very broad and would include the income from businesses which maintain a selling office in the United States or which even send a salesman here. In such cases the profit on the orders taken in the United States must be reported. Where a separate record of the cost of the goods has not been kept, the only fair method is to presume that the same percentage of profit is made on business done in the United States as is made on the total business transacted. If the foreign individual does a total business of $1,000,000, of which $100,000 is in the United States, if the total cost of doing this business is $800,000, the profit to be reported as from the United States is the same per cent of the business

done in the United States as the total profit is of the total business. In this case the total profit is $200,000, or 20 per cent. The profit from sources within the United States would be 20 per cent of $100,000, or $20,000. If this method is used the special expenses incurred in the United States cannot be deducted, as they have already been included in determining the profit of the entire business.

PROFIT FROM SALE OF LAND, BUILDINGS AND OTHER PROPERTY

Profit from sale of real estate is subject to tax.—For income tax purposes, where there has been an actual sale and transfer, profit will be considered as realized even though payment is to be made in installments; it is held that notes for deferred payments, secured by the title of the property, and bearing interest, are worth in cash, presumably, their face value. Therefore, the entire profits realized by individuals from the sale of real estate or other property will be taxable except where the property in connection with which the profit is obtained was acquired prior to March 1, 1913, and in that case the profit will be the difference between the selling price and the fair market value of the property as of March 1, 1913. But where lots are sold on a monthly installment basis, and title remains in the seller until the last payment is made, and where a fixed amount is received each month in payment of the total purchase price, the monthly installment received must be considered part profit and part cost. For example, let it be supposed that *A* sells 10 lots for $400 each, receiving $100 down and $5 a month on each lot. Let it be supposed, further, that the cost of each lot, including cost of improvements, sewers, walks, etc., was $300, and that the cost of the 10 lots sold was $3,000. One-fourth of the sale price, therefore, is profit. It would be necessary to consider three-fourths of every dollar re-

ceived in payment as cost and to consider one-fourth as profit. Thus, if $2,400 had been received on account of the sale price of these lots, the profit to be returned would be $600.

Appreciation and depreciation of good-will.—Good-will, for income tax purpose, is capable neither of appreciation nor of depreciation, and should be eliminated from any calculations of income. A book entry setting a value upon the good-will and thereby creating a surplus should be ignored in the preparation of the income tax report. Therefore, any stock dividend declared out of surplus which consists merely of an increased value placed on the good-will of a corporation is not being paid from earnings of the corporation and would not be income to the recipient. But, if an individual sells his good-will or stock dividend, the sum received for it would be shown in the increased price he receives for his assets and would be included as income, as being a profit on the sale of the assets.

How to ascertain profits on stock transactions.—When stock is purchased for a price lower than the market price at the time of reporting yearly income, such increase should not be considered as profit, inasmuch as it is only an appreciated value on the books of the reporting individual and is not an established profit due to a completed transaction. Thus, if stock is purchased on March 10th at 90 and is retained by the purchaser, and, on the December 31st following, the stock is selling in the open market at 95, the 5-point market increase will be disregarded and not reported as income. On the other hand, if stock is purchased at 90 and is actually sold during the year for 95, the 5-point gain must be reported as income. Of course, in the first case, if the stock is sold in some subsequent year at 95, the 5-point gain must be reported in the year of the sale of the stock.

When various parcels of stock of the same issue are

bought and sold at different dates, the shares sold, whenever possible, should be identified by the number of the certificates covering them. When stock is sold, and its identity cannot be determined, it should be charged against the stock first purchased and remaining unsold. Thus, on March 20th *A* buys 100 shares of Southern Pacific stock at 83. This stock is represented by certificate No. 1037. On April 10th, *A* buys 100 more shares of the same company at 89. These shares are represented by certificate No. 2419. On June 10th *A* sells certificate No. 2419, representing 100 shares of Southern Pacific, at 90. In this case *A* reports a profit from the transaction of $100. But if *A* did not have a record of the numbers of the certificates representing the shares he would have to report a profit of $700, for the profit would then have to be charged against the stock first purchased.

Exchange of securities through reorganization. — The Treasury Department has held that no profit or loss will be taken into consideration for the purpose of the income tax unless it has been realized as a result of a closed and completed transaction. A closed and completed transaction is defined as one in which an asset is disposed of for cash or for assets other than cash at a fixed or determined value at the time the transaction is consummated.

Where an individual holds the securities of a corporation and as a result of a reorganization he exchanges his securities for the securities of the new corporation, the question arises as to whether such an exchange is a closed and completed transaction under the above definition. If it is held to be a completed transaction, what is the measure of the profit or loss to be reported? The attitude of the Department formerly was that such transactions were merely an exchange in kind and that no profit or loss could be determined until the new securities were actually sold. The meas-

ure of profit or loss would then be the difference between the price realized for the new securities and the cost (or, where the stocks were purchased prior to March 1, 1913, the value at that date) of the original securities.

However, it was later held that, for income tax purposes, where securities in one company were exchanged for securities in a reorganized company, the transaction would be treated as a sale of the original securities, and the profit or loss would be the difference between the value of the old stock March 1, 1913 (or date of purchase subsequent to that date), and the value at which the same stock was given in exchange for the new stock. In the particular case before the Commissioner the stock of the New York Title Insurance Company was exchanged for stock of the New York Title and Mortgage Company at $50 per share; that is, for each $100 par value of stock in the old Title Insurance Company there was given $50 par value of stock in the new Title and Mortgage Company. The assets were placed upon the books of the new company at approximately the same figure as that at which they were carried by the old company, thereby creating a surplus upon the books of the new company, and a portion of such surplus was then marked off by reason of the depreciation in market value of the old stock below the book value. The Commissioner held that this constituted a closed transaction and that the stockholders of the old New York Title Insurance Company could deduct as a loss the difference between the cost price of the stock (the market price March 1, 1913, if the stock was purchased prior to that date) and $50 per share, to the extent that such losses, however, did not exceed gains from other similar transactions during the same year.

This position, which has been since modified, offered a loophole for fraud. To illustrate: Company *A*, with assets of $100,000 and a capital stock of $100,000

(1,000 shares), sells its assets to company *B* for the entire capital stock (500 shares, par $100) of company *B*, which it distributes to its own stockholders. Stockholders of company *A* receive only $50 of new capital stock for each $100 of the old stock. Under the ruling just cited the stockholders would be allowed to deduct as a loss, subject to the limitations on losses hereinafter described, the difference between the cost of the stock and $50. Actually no loss has been incurred. Company *B* has exactly the same assets that company *A* had. Each stockholder has the same proportionate share of these assets as before the reorganization.

Completed transaction defined.—In August, 1917, the Treasury Department took the position that in the sale or disposition of capital assets a closed and completed transaction is held to be one in which an asset is disposed of for cash or for assets other than cash at a fixed or determined value, that is, for cash or its equivalent in value at the time the transaction is consummated. If the assets are exchanged for other assets of a like character, and no account is taken of compensatory value, it will be held that such a transaction constitutes merely a change in the form of assets, and the investment will be considered a continuing one, no profit or loss to be taken into account until the assets are disposed of for cash or its equivalent.

This attitude appears to be sounder than the one taken in the second case cited and will no doubt be maintained by the Department.

Sale of rights to subscribe to stock. — Income received from the sale of rights to subscribe to new stock in a corporation in which a person is a stockholder must be included in his report. If the rights are not sold, but are permitted to lapse or are used to acquire stock of the company, it would seem that they in no way affect the income of the reporting individual. At least

that seems at present to be the attitude of the Treasury Department.

Profits on sale of securities.—When stock was purchased prior to March 1, 1913, the method of determining the gain to be reported from a subsequent sale is to take the difference between the selling price and the average market for that stock on March 1, 1913.

How to determine fair market price of stock as of March 1, 1913, when subsequently sold.—The fair market price or value as of March 1, 1913, is held to be as of the entire day of March 1, 1913, and in case of a variation between "opening and closing price" the fair value would be determined by taking the average price for the day. This is conditioned, however, upon the showing by the taxpayer that the "Exchange" quotation represented the fair market price or value of the stock, as it is this "fair market price or value" which is to control, in whatever manner that fact may be ascertained.

Computing profits on sales of securities left by decedent.—If securities are sold by the beneficiary at a price greater than the appraised value placed upon them in the settlement of the estate, the gain in value is income of the beneficiary subject to tax, and such gain must be included in the report of the beneficiary.

If securities belonging to an estate are sold prior to the settlement of the estate by the administrators or trustees at a price greater than their appraised value as of the date of the decedent's death, the amount of gain derived from the transaction is considered income accruing to the estate and subject to income tax, and should be included in the return filed by the administrator.

Profits from sale of property acquired by gift are subject to tax.—As previously stated, all profits derived from the sale of property acquired by gift are subject to the tax. This profit is the difference between the selling

price and the appraised or fair value of the property at the time of receiving the gift, or its fair value as of March 1, 1913, if the gift was received before that date. It must be remembered that the gift itself is not considered income when it is received by the donee, nor is it deductible from the income of the donor.

Profits derived from sale or exchange of farm products.—All income derived from the sale or exchange of farm products, whether produced on the farm or purchased and resold by a farmer, is income for the year in which the products were actually marketed and sold.

A farmer is not required to report as income the value of the farm produce which he raises and which is consumed by himself and family; and any expense incurred in producing such products so consumed cannot be claimed as an expense of this business. If a farmer exchanges his produce for merchandise, groceries, etc., or in any manner disposes of his produce in other ways than by selling it, he should include as income the regular price placed upon the goods so exchanged for the produce, or if no exchange price has been agreed upon, then the fair market value of the goods received in exchange for his produce.

Rents received in crop shares are income in the year during which the crop shares are reduced to money or a money equivalent. For example, if *A,* the land owner, has the right to one-third of the crop, the other two-thirds going to the party who supplies the seed, implements and labor, the owner, *A,* would not report his share of the crop till he had sold it or consumed it.

The exemption from the tax of farm products consumed applies only to those products raised by a farmer and consumed by himself and his family; it does not apply to farm products acquired as crop shares or through barter.

The above rulings apply only to those who cultivate or manage farms for gain or profit.—A person cultivating or

operating a farm for recreation or pleasure, on a basis other than one in accordance with the recognized principles of commercial farming, the result of which operations is a continual loss from year to year, is not regarded as a farmer. In such cases, if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from sale of products should be ignored in rendering a return of income; and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions in the return of income derived from other sources.

RENTS

Rent may be returnable as income for year in which received.—Rent is the gain or profit which accrues to the owner of a piece of property from the tenant for the use of that property. In a case where rent is not paid during the year for which it applies, the landlord may include in his return of annual net income only the rents actually paid to him within the year. For example, the rent paid on January 5, 1918, for the months of November and December, 1917, may be reported as income for the year 1918, or, if the landlord so desires, he may report the rent as of the date when it actually became due and payable, provided he keeps his books of accounts on the accrual basis and not upon the cash basis, as hereinbefore explained. (See p. 46.)

Where property is handled through an agent, who remits to the owner the net proceeds after paying taxes and expense, the owner should report the total amount of rents collected by the agent, and under expenses take credit for the expenses paid by the agent.

Board, lodging, crops and other consideration received in lieu of cash for rent is income.—If an owner of a piece of property rents it and receives as rent his board or lodging or a share of the crops raised on the property, the value of the board or lodging or share of the crops

is considered income and therefore should be included in the return of net income. If the tenant works property on shares, the landlord should report the money received from the sale of the crops in the year in which they are sold.

Tenants' improvements are income to the owner of the property.—Where a tenant under the provisions of a lease erects a building or makes an improvement which reverts to the owner, it must be reported as income by the owner of the property at the expiration of the lease. The amount of gain or profit is the difference between the cost of the building or improvement and a reasonable allowance for the exhaustion, wear and tear of the property.

INTEREST

Interest is returnable as income in the year received.—Interest on notes, ordinary mortgages, and corporate and other obligations should be entered on the annual return for the year in which such payments were received, unless books have been kept on an accrual basis.

Interest which accrued prior to March 1, 1913, but which is paid in the current year is not taxable.

Interest on bonds of the second Liberty Loan and on War Saving Certificates in excess of $5,000 par value should also be reported. This interest is exempt from the normal tax and also from the super-tax, but from the latter only to the extent of the interest on $5,000 par value of bonds or certificates. Interest on the 3½ per cent Liberty Bonds is not to be reported as income, since these bonds are not subject to any income tax.

Interest on bank deposits must be returned as income.—Interest paid, or accrued and unpaid, must be included in the annual income return of the person entitled to receive such interest, whether on open account or on a certificate of deposit.

Interest accrued on bonds at time of purchase and sale.—Interest accrued on bonds at time of purchase and sale should be reported by the vendor and not by the vendee. Where the purchaser of bonds pays, in addition to the price of the bonds, the amount of accrued interest, he should include in his return *only* such interest as has been earned after the purchase. In such a case the vendor considers as income the interest which has accrued on the bonds up to the time of their sale. For example, *A* owns one $1,000 *X* 6 per cent bond, interest payable January 1 and July 1. On April 1, *A* sells the *X* bond to *B* for $1,000 plus accrued interest, i.e., $1,030. In that case *A* must report as income the $30 interest accrued on the bond up to April 1, when it was sold to *B*. *B* will receive an interest check of $60 on July 1. Only $30 of this need be reported, for only $30 interest was earned on the bond after *B* purchased it, i.e., between April 1 and July 1.

Bonds purchased at a premium.—When a 6 per cent bond which has 10 years to run to maturity is purchased at 119 (i.e., for $1,190), the *real* income from the bond is not $60. Some business men might consider only the fact that they receive $60 each year as interest and lose sight of the fact that at the end of the 10 years they will receive only $1,000 for the bond which cost $1,190. This means a loss of $190. Insurance companies and other concerns which own a large number of bonds would distribute this loss over the life of the bond so that their interest account would show an annual income on this bond of $41 instead of $60.[1]

To protect himself, the individual investor should follow the example of these concerns. If he were to report the income as $60 each year, he would have to

[1] For the scientific method of "amortization," as this process is called, see Sprague's "Investment Accounting."

deduct as a loss at the end of the tenth year the difference between $1,190 and $1,000, or $190. This loss would then be regarded by the Treasury Department as a "loss incurred in transaction other than from business," and subject to the limitations imposed by the Department on the deduction of such losses.

Bonds purchased at a discount.—When bonds are purchased at a discount, the *real* income of the holder of the bond is more than the bond interest rate. For example, a 10-year, 6 per cent $1,000 bond, bought at $800, gives the purchaser not only an income of $50 a year, but also a profit of $200 at the end of 10 years, representing the difference between what the purchaser pays for the bond, $800, and what he receives from the corporation at the end of 10 years, $1,000, which is the par value of the bond. This profit of $200 may be apportioned over the life of the bond and an equal part of the profit reported as income during each of the ten years, or the entire $200 profit may be reported at the end of ten years. Under the first method, the holder of the bond would report each year an income of $70, representing $50, the interest received from the corporation, plus $20, one-tenth of the $200 discount.[1] Under the second method the holder of the bond would report an income of $50 each year for 9 years, and an income of $250 in the tenth year.

It must be remembered, however, that if the premium is written off over the life of the bond the discount on bonds must also be treated in the same manner. If the individual were to write off the premium on his bonds and not accumulate the discount his records would not reflect his true income and would not be ac-

[1] If the scientific method of figuring the amortization of the discount were used, the holder of the bond would report an annual income of only $65.90, i.e., $50 plus $15.90, for $15.90 laid aside during each of the ten years and earning 5 per cent interest (the interest rate of the bond) would amount to $200 at the end of 10 years.

cepted by the Department because of the inconsistency of his accounting methods.

Interest on bonds received by legatee.—The ruling—that accrued interest must be apportioned between a buyer and a seller of a bond in proportion to the length of the interest period during which each was the owner of the bond—does not apply to the interest on bonds received by a legatee. The legatee is required to return as income the full amount of interest received by him on a bond, notwithstanding the fact that a part of the first coupon, payable after he received it, has been added to the bond and included in the gross estate of the decedent, thereby becoming taxable under the Estate Tax law.

Interest on certain public obligations taxable.—Where a municipality purchases a public utility subject to a mortgage, the income from which is taxable, the mortgage retains its original character even though the municipality assumes the mortgage indebtedness and pays the interest on it. The interest on such obligations, accordingly, is taxable income.

Interest from bonds of exempt organizations should be considered as income subject to tax. The fact that a corporation, joint-stock company or association is exempt from the income tax does not exempt the interest on its obligations from the tax when received by an individual or corporation subject to the tax.

Fiduciaries.—Income received from fiduciaries includes all income received from guardians, trustees, executors, administrators, receivers, conservators, or other persons acting in a fiduciary capacity.

Such part of the income received from fiduciaries as represents dividends from domestic corporations should not be included under the heading of "interest," but should be shown separately under the heading of "dividends received through fiduciaries." This separation is necessary in order that the amount of such dividends

may be deducted in computing the normal tax. In order to do this the beneficiary should obtain from the fiduciary a report of the income and expenditures of the estate so that he may determine how much of his share is from dividends or from non-taxable sources. Such part of the beneficiary's income as is from non-taxable sources should be omitted from his return entirely.

PARTNERSHIP INCOME

Partnership gains and profits.—No return is required of partnerships as such. Each member of a partnership should report, as an individual, his share of the *net* profits of the partnership.

Limited partnerships are held to be corporations, for the purpose of the income tax, and in their organized capacity are subject to the income tax as corporations. The individual members of the limited partnership should report their share of the profits in the same manner as that in which they report dividends on stock of corporations. The same rule also applies to members of a joint-stock company.

When income from partnership accrues.—The Income Tax law of September 8, 1916, section 8, subdivision (e), provides that "Persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of the partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid under the provisions of this title."

The income from a partnership accrues to the individual partner at the time his distributable interest is determined and reduced to possession. The member of a partnership should include in his return his interest in the partnership profits ascertained at the end of the business year falling within the calendar year for

which his return is rendered. Such share of profits should not be again included in the return when it is actually paid to the partner. To illustrate: *A* is a member of a partnership whose fiscal year ends January 31. His share of the profits of the partnership for the fiscal year ending January 31, 1917, should be included in his report of income for the year 1917, and any moneys actually received by him in 1918 from the earnings of the partnership for the fiscal year ending January 31, 1917, will, therefore, not be reported by him as income for the year 1918.

Partnership profits taxed at rates in effect in year in which they were earned.—Section 8, paragraph (e), of the Income Tax law, as amended October 3, 1917, provides that: "A partnership shall have the same privilege of fixing and making returns upon the basis of its own fiscal [1] year as is accorded to corporations under this title. If a fiscal year ends during 1916 or a subsequent calendar year for which there is a rate of tax different from the rate for the preceding calendar year, then (1) the rate for such preceding calendar year shall apply to an amount of each partner's share of such partnership profits equal to the proportion which the part of such fiscal year falling within the calendar year bears to the full fiscal year, and (2) the rate for the calendar year during which such fiscal year ends shall apply to the remainder." In the illustration in the preceding paragraph eleven-twelfths of *A's* share of the profits of the partnership which he reported for 1917 is subject to the tax at the rates in effect for the calendar year 1916. The remaining one-twelfth is taxable at the rates in effect for 1917.

The section of the law quoted above was not in the Income Tax law of September 8, 1916, but is included

[1] A fiscal year of a business concern is its twelve months' business period, which may or may not coincide with the calendar year. In the Income Tax law the use of the term "fiscal year" implies that the year in question does not coincide with the calendar year.

in the amendment of October 3, 1917. The Department had therefore taxed all partnership profits included in the 1916 returns at the rates in effect for the calendar year 1916. This new section of the law, however, is retroactive to 1916, and therefore affects the 1916 returns. Individuals who included in their 1916 returns profits from a partnership for a fiscal year part of which fiscal year fell within the calendar year 1915, it appears, are entitled to a refund of the difference between the tax as assessed under the 1916 rates and the amount which should have been assessed under the 1915 rates, on such proportion of the profits from the partnership as should have been taxed only at the 1915 rates. To refer to the previous illustration, *A* in his report of income for the calendar year 1916, which he filed on or before March 1, 1917, included his share of the partnership profits for the fiscal year ended January 31, 1916. His income was taxed at the rates fixed for the calendar year 1916. According to the amended provisions of the law he should have been taxed at the 1915 rates on eleven-twelfths of his income from the partnership. He should make application for a refund for the difference between what he was assessed and what he should have been assessed.[1]

Non-taxable income of partnership to be omitted from returns of partners.—Any non-taxable items of income, such as interest on State, municipal or government bonds, including Liberty Bonds of the first issue, or the bonds into which they are converted, but excepting interest on second Liberty Bonds,[2] should be deducted

[1] The method of obtaining a refund is discussed on p. 27.

[2] Interest on bonds of the second liberty loan is not entirely free from the income tax. It is free from the normal tax, but is free from the supertax only to the extent of the interest on $5,000 par value of the bonds.

No tax is levied upon a partnership as an entity, the tax being upon the members of the partnership. Each partner will report his share of the net profits of the partnership, including the interest on the Liberty Bonds of the second issue in excess of the interest on more than $5,000 par value of such bonds. The interest on the principal, $5,000 or less of Liberty 4s,

by each of the individual partners from his share of the partnership profits. Such income is exempt from tax even though the bonds are deposited as collateral to secure loans the interest on which is deducted as a business expense by the partnership.

Dividends should be shown separately.—Each partner should show his share of dividends received by the partnership under a separate caption, i.e., "Dividends Received from Partnership." If he includes such dividends under partnership profits he will not be allowed to deduct them in computing the normal tax.

Returns may be required of partnerships.—Though partnerships are not taxable as such, the Commissioner of Internal Revenue has power to require any partnership to file a report of its net profits, with a statement of its members, their names and addresses, and their respective interests in the net profits earned.

Determining net profits of a partnership.—The net profits to be reported by an individual partner should be his share of the net profits of the partnership as shown by its books, less the deductions allowed an individual in a similar business.

The amount of losses which may be deducted by a partnership is subject to the same restrictions as that placed upon individuals. Therefore, in determining the net profit of a partnership that does not own a membership in a stock exchange, or if dealing in securities is not a part of its regular business, losses actually sustained in stock transactions entered into for profit

is not taxable and need not be reported.

The member of a partnership which owns Liberty Bonds will be regarded as an individual owner of an amount of bonds proportionate to his interest in the partnership. Thus if the partnership, composed of three equal partners, owns $6,000 of Liberty Bonds, each member is regarded as owning $2,000 of the bonds, and the interest is not reportable or taxable. If, however, such a member himself owns additional Liberty Bonds, not included in the partnership assets, in an amount sufficient to make his individual and partnership holdings together as much as $5,000 or more, he must report and pay taxes on interest on bonds which he holds in excess of the principal amount of $5,000.

may be deducted in an amount not exceeding the profits derived from similar transactions entered into for profit.

If a partnership, however, is engaged in the business of purchasing and selling securities, or if it owns a membership in a stock exchange, the full amount of losses sustained on such transactions may be deducted.[1]

INTEREST ON BONDS AND DIVIDENDS ON STOCK ISSUED IN FOREIGN COUNTRIES

Interest on bonds and dividends on stock issued in foreign countries.—Interest on bonds, deeds of trust, notes and other similar interest-bearing obligations issued in foreign countries must be reported in full by citizens and resident aliens, but need not be reported by non-resident aliens, even though the securities on which the interest is paid are physically present in the United States.

Dividends on stock of foreign corporations, joint-stock companies or associations or insurance companies which are engaged in business in foreign countries should also be reported as income.

Where the *entire* net income of a foreign corporation is from sources within the United States, the dividends on the stock of such a corporation are treated in like manner as are the dividends on stock of a domestic corporation and may be deducted in computing the normal tax. Such dividends, in order to be deductible, should therefore be included under the caption "dividends received from domestic corporations."

If only *part* of the net income of the corporation is from sources within the United States, the dividends on the stock of the corporation will be treated as if the corporation were entirely engaged in business abroad and will, therefore, not be allowed as a deduction in computing the normal tax.

Foreign income not remitted to United States.—Where the interest on bonds or dividends on the stock of a for-

[1] See Chapter on Deductions, p. 120.

eign corporation owned by a resident American citizen is credited to his account abroad but not remitted to the United States he should return the income at the rate of exchange prevailing at the time it was credited to him.

On the other hand, if the income is neither credited to him abroad, nor received by him here, the resident American citizen need not report the income, which he could obtain if he wished to, unless he keeps his books on an accrual basis. This would apply, for example, in the case of a resident American citizen owning some foreign corporation or Government coupon bonds, the interest on which is payable only on surrender of the coupon. If the American citizen did not clip his coupon and send it abroad for payment, and if it were not paid during 1917, he would not be compelled to report the value of the coupon as income, until he collected it.

SPECIAL SOURCES OF INCOME

Royalties from mines, oil wells, patents, franchises and other legalized privileges are returnable as income.—In the case of mines operated by a lessee on a royalty basis, the lessor, in disposing of his ores or natural deposits, is receiving back part of his capital due to the depletion of the mine. The lessor should report the total royalty received as income, and deduct a proper amount representing the actual depletion of the property.[1]

Amount received from sale of royalty and patent rights is returnable as income after deducting cost.—In the sale of a patent or of royalties, where all rights and title to the patent are surrendered, the amount received for such a sale, less the aggregate amounts expended in perfecting the invention and obtaining the patent, is income. If only the right to manufacture and sell under a patent is sold, the total amount of the price

[1] The question of depletion of mines and oil wells is considered in the chapter on Corporation Deductions, p. 233.

received for the right is income. The owner of the patent will, however, be allowed to deduct a reasonable allowance for the depreciation of the patent.[1]

Pensions.—Pensions received from any private source or from the United States Government must also be reported as income subject to taxation. But pensions received by an employee of a State or any political subdivision of a State, for services rendered to the State or its political subdivision, are exempt and need not be reported.

Damages recovered.—Damages recovered through lawsuits or settlements, less the lawyers' fees and all expenses incurred incident to the suit or claim, must be reported as income. In the case of a recovery of damages for personal injuries, for example, lawyers' fees, doctors' bills, medical bills, the cost of medicines, and all other expenses incurred should be deducted from the amount of the judgment collected, and only the *net* amount should be reported.

Accident insurance and employees' accident compensation.—Money received by a person from accident insurance, less all insurance premiums paid for the insurance and less all expenses incurred as a result of the accident, should also be reported as taxable income. The expenses which may be deducted, in addition to insurance premiums, are mentioned in the preceding paragraph. Only the *net* amount should be reported as income. The same rules apply to money received by a person from his employer or an insurance company under State or Federal accident compensation laws.

It must be borne in mind that the proceeds of accident insurance policies or the accident compensation paid upon the death of the person insured to the beneficiaries will be treated the same as the proceeds of life insurance policies, heretofore discussed.

[1] See chapter on Corporation Deductions, p. 230.

Income from bad debts charged off in a previous period.—If payments are received on account of debts charged off as bad debts in previous years they must be included as income during the current year. This is the ruling, even though such bad debt was charged off prior to March 1, 1913.

Alimony.—The Treasury Department has held that alimony is income and must be reported as such (T. D. 2090). A recent decision in the Supreme Court (*Gould vs. Gould,* decided November 19, 1917) holds that alimony in the hands of the recipient is not subject to the income tax, nor is it a deductible item of expense of the payor.

DIVIDENDS

Dividends.—Under this heading should be included dividends received from domestic corporations, joint-stock companies or associations and insurance companies and from foreign corporations whose entire net income is derived from sources within the United States. The dividends should be classified according to their source into:

1. Dividends received directly from corporations.
2. Dividends received through fiduciaries.
3. Dividends received through partnerships.

Dividends are exempt from the normal tax, and are therefore subject only to the super-taxes. Individuals having an income of less than $5,000 are not taxed on income received in the form of dividends. The reason for exempting dividends from the normal tax is that the income represented by the dividends has been taxed when earned by the corporation, and therefore should not be taxed again when distributed to the stockholder. All dividends received, unless specifically exempt from all income taxes (see following pages) must be included in the return. In calculating the normal tax, the amount of dividends should be deducted.[1]

[1] See the chapter on Returns and Computation of Tax, p. 158.

It is important that any dividends included as income as received through fiduciaries or through a partnership be shown on the report as dividends, in order that such amount may be deducted in computing the normal tax.

Income received from private banks considered as dividend.—In the case of private banks which have the form of corporations and which are held to be associations within the meaning of the Federal Income Tax Law, the income which the members of the association receive from the bank because of their investments will be considered dividends.

Taxes paid by bank for owners of bank stock considered a dividend.—Taxes assessed against the stockholders of a bank and paid by the bank in their behalf are considered an additional dividend to the amount of the taxes paid and should be included in the returns of the individual stockholders.

Dividends from paid-up policies considered income.—Dividends from paid-up insurance policies are considered income to the recipient, and must be included in the annual return of income. They are considered the same for the purpose of the tax as dividends or net earnings from corporations.

Record owner of stock is not to include dividend in return if stock is owned by another.—The record owner of stock is not required to include in the income tax return any amount of dividends received on stock that actually belongs to another. But if a question should be raised as to why dividends on stock recorded in the name of an individual, firm or corporation are not included in the record owner's income tax return, such owner will be required to show conclusively that the actual ownership of the stock rested with another.

Profits of limited partnerships considered dividends.—The profits of limited partnerships, which make returns in the same manner as corporations make returns,

will be treated as dividends of corporations and must be reported in the returns of individual members in the same manner as are dividends upon the stock of corporations. That is to say, members of a limited partnership report only so much of the profits as they receive (like stockholders of a corporation), and not their undistributed share of the profits (like partners in a general partnership).

Dividends declared from reserves.—Where a corporation declares a dividend out of surplus created by crediting reserves which were previously set aside to meet depreciation and depletion of property, such dividends constitute income to the stockholders and must be reported as income if the reserves were accumulated subsequent to March 1, 1913. But if the reserves were created prior to March 1, 1913, the dividends need not be included as income. In the latter case, if the stock on which the dividends were paid is sold, in calculating the profit on the sale of the stock the dividends must be subtracted from the original purchase price, and the difference subtracted from the selling price of the stock. In calculating the loss, if any, on the sale of the stock, the selling price is subtracted from the cost minus the dividends mentioned.

Dividends paid from surplus created by revaluation of assets are not income.—As any surplus created by a book appreciation of assets is not income to the corporation, so the dividends paid from such surplus are not income in the hands of the stockholders. The same rule holds true as to dividends paid from a surplus created by setting up a good-will account upon the books of the corporation.

If such dividend is paid in cash and the stock on which the dividends were paid is subsequently sold, the amount of these dividends must be considered in determining the profit or loss from the sale. The amount of these dividends should be deducted from

the cost, if the stock was purchased subsequent to March 1, 1913, or from the fair value March 1, 1913, if it was purchased prior to that date. The difference between the resulting figure and the selling price will be the amount of profit or loss on the transaction.

To illustrate: *A* owns 100 shares of stock which he purchased in 1916 at $90 a share. In March, 1917, he received a dividend of $5 a share, the dividend being paid out of a surplus created by revaluing the plant of the corporation. In October he sells the stock at $100 a share. He would not be required to report the dividend as income,[1] but would be required to include a profit on the sale of the stock of $1,500, arrived at as follows:

Cost of 100 shares at $90............	$9,000
Dividend of $5 a share.............	500
Net cost	$8,500
Selling price of 100 shares...........	10,000
Profit	$1,500

If the dividend is paid in stock, instead of in cash, and some or all of the stock is subsequently sold, the situation is quite complicated. To use the figures of the illustration above:

A at the beginning had 100 shares which cost him $9,000. He receives 5 shares as a stock dividend, the dividend being paid out of a surplus created by revaluing the plant of the corporation, or by setting up a good-will account. He now has 105 shares. What is the cost per share? The Treasury Department requires that the 100 shares and the 5 shares be considered as separate lots, the method used when different lots of the same stock are purchased, and that the 100

[1] He should, however, attach a statement to his return stating the amount of the dividend, and the reason for not including it as income.

shares cost be regarded as $90 a share, and the 5 shares nothing. If we sold the 5 shares, we would have to report the entire sales price as income. The sounder practice would seem to be to consider the entire 105 shares as one lot which cost $9,000, or $85.71 a share. It then would not make any difference how many shares are sold; the profit or loss would be the difference between $85.71 per share and the selling price.

Dividends need not be paid in cash.—The Income Tax Law, section 31(a) states:

"That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint stock company, association or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock [1] of the corporation, joint stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of the earnings or profits so distributed."

Scrip dividends.—Scrip dividends [2] are to be treated as cash dividends to the face value of the scrip. The transaction is held to be a payment in cash of the dividend and an investment of the cash in the scrip.

Dividends paid in bonds issued under Act of Congress approved April 24, 1917.—The fact that a dividend was paid in Liberty Bonds of either the first or second issue does not make the dividend exempt from tax.

Dividends from surplus earned prior to March 1, 1913, not taxable.—The law as stated above specifically exempts from the tax any earnings or profits accrued prior to March 1, 1913. This provision first appeared in the Income Tax law of September 8, 1916. Prior to that time dividends were taxable as income when received,

[1] See discussion on stock dividends later in this chapter, pp. 87-98.

[2] Scrip dividends are dividends paid in the form of promissory notes instead of in cash.

regardless of whether or not the profits from which they were paid were earned or accrued prior to March 1, 1913. This old ruling was attacked but was upheld in the recent decision in the case of *Gulf Oil Corporation v. C. G. Lewellyn, Collector,* decided in the United States Circuit Court of Appeal, Third Circuit. There is no doubt that under the present law any dividends received from earnings accrued prior to March 1, 1913, are not taxable. There is some question as to the method of determining from what particular earnings a dividend is paid.

Prior to August 6, 1917, a corporation could declare a dividend and state that it was paid out of surplus or undivided profits accumulated prior to March 1, 1913. Such a statement would be accepted as cause for exempting such dividends provided that there was a surplus on March 1, 1913, out of which this dividend could have been declared. The 50 per cent dividend of the American Radiator Company may be used as an example: This dividend was declared February 1, 1917, payable March 15, 1917. At the time of declaration it was stated that the dividend was paid out of surplus acquired prior to March 1, 1913. The surplus account of the company follows:

Year Ended	Net Income	Dividends	Left in Surplus	Total Surplus
Jan. 31, 1910..	$971,600	$610,000	$361,600	$4,526,650
Jan. 31, 1911..	1,772,517	779,000	993,517	5,520,167
Jan. 31, 1912..	1,312,052	825,000	487,052	6,007,220
Jan. 31, 1913..	1,696,193	1,476,900	219,293	6,226,513
Jan. 31, 1914..	2,081,267	1,603,590	477,677	6,704,190
Jan. 31, 1915..	2,289,075	1,865,680	423,395	7,127,586
Jan. 31, 1916..	2,364,593	1,519,336	845,257	7,972,843
Jan. 31, 1917..	2,604,068	1,579,696	1,084,372	9,057,215

Common capital stock outstanding Jan. 31, 1917	8,185,600
50 per cent dividend March 15, 1917........	4,092,800

On January 31, 1913, this corporation had a surplus of $6,226,513, which was still available on Feb. 1, 1917, and which was enough to cover the dividend declared. Stockholders of the American Radiator Company should therefore omit this 50 per cent dividend from their return. They should, however, attach a statement that the dividend is omitted because it was paid out of surplus acquired prior to March 1, 1913.

If this dividend had been distributed on or after August 6, 1917, the dividend would be treated as being declared from the most recently accumulated surplus or undivided profits (Income Tax Law, Sec. 31, b.) In other words, the dividend would have to exhaust first the surplus created in 1917, next the surplus created in 1916, and so on. The dividend, instead of being paid out of the surplus created prior to March 1, 1913, would be treated as follows:

Paid out of 1917 earnings	$1,084,372
Paid out of 1916 earnings	845,257
Paid out of 1915 earnings	423,395
Paid out of 1914 earnings	477,677
Paid out of earnings prior to March 1, 1913	1,262,099
	$4,092,800

The holder of 20 shares of the common stock would receive $1,000 as a dividend. Of this $1,000, 30 8/10 per cent $\left(\frac{12621}{40928} = .308\right)$ or $308, would be excluded from his return as earned prior to March 1, 1913.

Dividends taxable at rates in effect for year when profits were earned.—In the example cited in the previous paragraph the $692 calculated to have been earned after March 1, 1913, would for tax purposes, be apportioned as follows:

From 1917 earnings	$265.00
From 1916 earnings	206.50
From 1913 to 1915 earnings	230.50
Total	$692.00

and taxed at the rates in effect for the respective years (Income Tax Law, Sec. 31, b.) That is, $265 would be taxed at the rates in effect for 1917, $206.50 at the rate in effect for 1916, and $230.50 at the rate in effect for 1913 to 1915, inclusive.

This represents the first recognition by Congress and the Treasury Department of the fact that a dividend declared in one year may represent the earnings of a previous year, and should be taxed at the rate for the year in which it was earned. Prior to 1917, income from dividends was taxed at the rates in effect when reported.

It will be noticed that the fiscal year of the American Radiator Company ends January 31. The income of the fiscal year ending January 31, 1917, is treated as being entirely earned in 1917. The Treasury Department has always held that no income accrues to the corporation until the close of the fiscal year unless the books are actually closed at an intervening period. If the American Radiator Company had closed its books on July 31, 1916, the net income for that half year would of course be treated as earned in 1916.

It must be remembered that the date when the earnings, out of which the dividend was paid, were accumulated by the company declaring the dividend, and not the date when such earnings were accumulated by a subsidiary, is the deciding date in determining the rates at which the dividend should be taxed,. To illustrate: Company *A* receives a dividend on January 10, 1917, from its subsidiary, Company *B*. The earnings represented by this dividend were earned by Company *B* in

1916. On March 10, 1917, Company *A* paid a dividend to its stockholders, the dividend being paid out of the earnings received from corporation *B*. The stockholders of Company *A* must pay the tax at the rates in effect for 1917, because the earnings out of which the dividend was paid were not received by Company *A* until 1917.

1917 dividends are held to be paid out from the most recently accumulated surplus.—The law states that any dividend declared in 1917 and future years will be treated as being paid out of the most recently accumulated surplus or undivided profits. This provision does not apply to any dividends which are stated as being paid out of surplus acquired prior to March 1, 1913, distributed prior to August 6, 1917. To illustrate: The Bethlehem Steel Corporation on Feb. 15, 1917, declared a dividend of 200 per cent, which amounted to $30,000,000.

Surplus Account of the Bethlehem Steel Corporation

Year	Earnings	Dividends	Carried to Surplus	Total Surplus
1916	$43,593,968	$5,502,160	$38,091,808	$69,370,198
1915	17,762,813	1,043,560	16,719,253	31,278,390
1914	5,590,020	745,400	4,844,620	14,559,137
1913	1,941,963	745,400	1,196,563	9,714,517
1912	1,209,287		1,209,287	8,517,954
1911	2,038,979		2,038,979	7,308,667

No statement was made that the dividends were paid out of surplus accrued prior to March 1, 1913, either in whole or in part. Consequently, the dividends will be treated as paid out of the most recent earnings, i.e., the 1916 earnings, and they will be taxable at the 1916 rates.

The directors could have declared $8,517,954 of the dividend paid out of surplus accumulated prior to March 1, 1913. The remainder of the dividend, $21,-

482,046, could then have been treated as having been paid out of the 1916 earnings. The directors could not claim that the $21,482,046 was paid out of 1915 earnings.

SUMMARY OF RULES APPLICABLE TO 1917 DIVIDENDS

Dividends distributed prior to August 6, 1917, may be declared as out of surplus created prior to March 1, 1913. If not specifically declared as out of such surplus they will be treated as being paid out of the most recently accumulated surplus.

Dividends distributed subsequent to August 5, 1917, are considered as being paid out of the most recently accumulated surplus, regardless of the statement accompanying the dividend.

Stock dividends are income to amount of profits distributed.—The Income Tax Law, section 31, a, referring to stock dividends, reads in part: "Which stock dividend shall be considered income to the amount of the earnings or profits so distributed." In T. D. 2090, explaining the law, the Department said: "Stock dividends included in a return of income should be accounted for at the valuation placed upon the stock by the corporation when said stock dividends were issued." The valuation placed on the shares by the corporation can be found by dividing the amount of surplus distributed as a dividend by the number of shares distributed in payment of the dividend. To illustrate: a corporation distributes 500 shares of common stock in payment of a dividend declared from a surplus amounting to $50,000. The value at which the shares should be included in the return is $100 per share.

The practical effect of this provision is to treat a stock dividend as income to the extent of the par value of the stock received. The author cannot recollect any case in which stock was distributed as a dividend at any other figure than its par value.

The taxing of stock dividends at their full par value often results in a double taxation and a consequent injustice to the last purchaser of the stock. To turn to the case of Bethlehem Steel Company: Bethlehem Steel Common, (now class A, common) in 1914 could be bought at $40 a share. A person buying 100 shares in 1914 at 40 and selling them in January, 1917, at 415, would be taxed on the profit of $37,500. This would be no more than fair as he had actually made that profit on the transaction. Turning to the man who bought the stock at 415 in February, we find that he received a 200 per cent stock dividend in a new class B common stock on which he would be taxed on its par value, $20,000.

This taxes the holder on income which his capital never earned, as he made no profit by the receipt of the dividend. After receiving the dividend he holds 100 shares of class A common and 200 shares of class B common, the average market value of which for the month of March, 1917, was as follows:

100 shares class A at 135	$13,500
200 shares class B at 125	25,000
	$38,500
Original cost of 100 shares A	41,500
Market Loss	$ 3,000

Should the holder of these shares sell them subsequently for less than $61,500 (i.e. $41,500 + $20,000) he would be allowed to deduct the difference as a loss, subject to the restrictions on losses, see chapter on Deductions.

Stock dividends held not taxable under 1913 law.—The entire question of the taxability of stock dividends has been reopened by the decision of the United States Supreme Court in *Towne vs. Eisner,* decided January 7, 1918, which holds that a stock dividend declared January

2, 1914, should not have been regarded as income under the provisions of the law of October 3, 1913. The decision, written by Justice Holmes, follows:

Henry R. Towne Plaintiff in Error, *vs.* Mark Eisner, Collector of United States Revenue for the Third District of the State of New York.	In error to the District Court of the United States for the Southern District of New York.

Argued December 12, 1917.
Decided January 7, 1918.
Charles E. Hughes
George Welwood Murray
Charles P. Howland
Louis H. Porter,
Counsel for Plaintiff in Error.
John W. Davis, Solicitor General
Counsel for the United States.

Mr. Justice Holmes delivered the opinion of the Court.

This is a suit to recover the amount of a tax paid under duress in respect of a stock dividend alleged by the Government to be income. A demurrer to the declaration was sustained by the District Court and judgment was entered for the defendant. 242 Fed. Rep. 702. The facts alleged are that the corporation voted on December 17, 1913, to transfer $1,500,000 surplus, being profits earned before January 1, 1913, to its capital account, and to issue fifteen thousand shares of stock representing the same to its stockholders of record on December 26; that the distribution took place on January 2, 1914, and that the plaintiff received as his due proportion four thousand and one hundred and seventy-four and a half shares. The defendant compelled the plaintiff to pay an income tax upon his stock as equivalent to $417,450 income in cash. The District Court held that the stock was income within the meaning of the Income Tax Act of October 3, 1913, c. 16, Section II; A, subdivision 1 and 2; and B. 38 Stat. 114, 166, 167. It also held that the Act so constructed was constitutional, whereas the declaration set up that so far as the Act purported to confer power to make this levy it was unconstitutional and void.

The Government in the first place moved to dismiss the case for want of jurisdiction, on the ground that the only question here is the construction of the statute, not its constitutionality. It argues that if such a stock dividend is not income within the meaning of the constitution, it is not income within the intent of the statute, and hence that the meaning of the Sixteenth amendment is not an immediate issue, and is important only as throwing light on the construction of the Act. But it is not necessarily true that income means the same thing in the Constitution and the Act. A word is not a crystal, transparent

and unchanged; it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used. Lamar vs. United States, 240 U. S. 60, 65. Whatever the meaning of the Constitution, the Government had applied its force to the plaintiff, on the assertion that the statute authorized it to do so, before the suit was brought, and the Court below has sanctioned its course. The plaintiff says that the statute as it is construed and administered is unconstitutional. He is not to be defeated by the reply that the Government does not adhere to the construction by virtue of which alone it has taken and keeps the plaintiff's money, if this Court should think that the construction would make the Act unconstitutional. While it keeps the money it opens the question whether the Act construed as it has construed it can be maintained. The motion to dismiss is overruled. Billings vs. United States, 232 U. S. 261, 267. B. Altman-Company vs. United States, 224 U. S. 583, 596, 597.

The case being properly here, however, the construction of the Act is open, as well as its constitutionality if construed as the Government has construed it by its conduct. Billings vs. United States ubi supra. Notwithstanding the thoughtful discussion that the case received below we can not doubt that the dividend was capital as well for the purposes of the Income Tax Law as for distribution between tenant for life and remainderman. What was said by this Court upon the latter question is equally true for the former. "A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interest of the shareholders. Its property is not diminished and their interests are not increased. . . . The proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original shares together representing the same proportional interest that the original shares represented before the issue of the new ones." Gibbons vs. Mahon, 136 U. S. 549, 559, 560. In short, the corporation is no poorer and the stockholder is no richer than they were before. Logan County vs. United States, 169 U. S. 255, 261. If the plaintiff gained any small advantage by the change it certainly was not an advantage of $417,450, the sum upon which he was taxed. It is alleged and admitted that he received no more in the way of dividends and that his old and new certificates together are worth only what the old ones were worth before. If the sum had been carried from surplus to capital account without a corresponding issue of stock certificates, which there was nothing in the nature of things to prevent, we do not suppose that any one would contend that the plaintiff had received an accession to his income. Presumably his certificate would have the same value as before. Again if certificates for $1,000 par were split up in ten certificates, each for $100, we presume that no one would call the new certificates income. What has happened is that the plaintiff's old certificates have been split up in effect and have diminished in value to the extent of the value of the new.

Judgment reversed.

Mr. Justice McKenna concurs in the result.

Effect of "Towne vs. Eisner" decision on stock dividends paid in 1913, 1914 and 1915.—The court in *Towne vs. Eisner,* decided that under the provisions of the Income Tax law of October 3, 1913, stock dividends could not be taxed as income. All taxes collected on such dividends in 1913, 1914 and 1915 were wrongfully assessed and collected. All persons who paid an income tax on stock dividends in 1913, 1914 and 1915 are no doubt entitled to a refund and should file a claim for the same with the collector for the district in which the return, on which the tax was wrongfully assessed, was filed.[1]

Treasury Department holds stock dividends taxable under the 1916 and 1917 laws.—The only Income Tax law considered by the court was the October 3, 1913, law. But the wording of the decision is such that it may be inferred that the taxing of stock dividends is unconstitutional. Inasmuch as this part of the opinion was not necessary to the decision it is merely dictum and its weight is questionable.

The Treasury Department maintains that the decision does not change the right to tax stock dividends paid in 1916 and 1917. The basis of their argument is that the law of September 8, 1916, contains a provision (section 31, a) which specifically taxes stock dividends. This position of the department is shown in the following letter:

"TREASURY DEPARTMENT,
"OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
"*Washington, D. C., January* 10, 1918.

"TO COLLECTORS OF INTERNAL REVENUE,
AND INTERNAL REVENUE AGENTS:

"Please note carefully the statement below with reference to the effect of the decision of the Supreme Court of January 7, 1918, in the case of Towne vs. Eisner and see that it is given general publicity.

"DANIEL C. ROPER,
"*Commissioner.*

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[1] As yet the Treasury Department has issued no statement as to whether this particular case will apply to tax imposed upon stock dividends paid in 1913, 1914 or 1915 from profits earned by the corporation subsequent to March 1, 1913.

"Misapprehension exists as to the effect of the decision of the Supreme Court in the case of Towne vs. Eisner, handed down January 7, 1918. In this opinion it was held that under the Act of October 3, 1913, a stock dividend declared by a corporation January 2, 1914, was not properly regarded as income. It does not necessarily follow, however, that no stock dividends are to be held taxable under the provisions of the Acts of September 8, 1916, and October 3, 1917.

"The Act of October 3, 1913, which was the only Act before the Court in the case, contained no provision expressly providing for treating stock dividends as income, and the decision of the Court was to the effect that the Act was not to be construed as taxing such dividends. The Court did not decide that such dividends cannot be income within the meaning of the Sixteenth Amendment, but expressly recognized that the word "income" may have a different meaning in the Statute from the meaning in the Constitution.

"The Act of September 8, 1916, contains an express provision taxing stock dividends declared and paid out of earnings accrued since March 1, 1913. In the absence of a decision as to the legal effect of these express provisions contained in the latter Acts, the Bureau of Internal Revenue naturally will continue to be governed by the express provisions of the later Acts in reference to stock dividends."

Opinions opposed to Treasury Department's holding.— While the holding of the Department, it seems, is technically correct, the weight of the opinion outside of the Department is that the decision affects all the income tax laws and that the Supreme Court will so decide if a test case is brought before it.

The arguments supporting this position are brought out in the following editorial from the *New York Times.*

"TRIFLING WITH THE COURT" [1]

"The Commissioner of Internal Revenue says that income taxes will be collected upon stock dividends, the opinion of the Supreme Court under the law of 1913 to the contrary notwithstanding. The Collector relies upon the declaration of the law of 1916 that

" 'Dividends shall be held to mean any distribution made or ordered to be made . . . payable to shareholders, whether in cash or stock . . . which said stock dividend shall be considered income to the amount of the earnings or profits so distributed.'

[1] *New York Times,* January 12, 1918.

"No doubt Congress can tax either property or income, but it cannot tax both by simply declaring that one is the other, when the Supreme Court says that they are different. It is true that the court's decision arose under the statute of 1913, which contains no such provision as the one quoted above. But the court's decision was on principle, not on the words of the statute, and the principle is applicable to both statutes. The court decided that income must be something which is separated from the principal, as crops are severed from land, or dividends paid in cash are separated from the resources of the company. A share dividend separates nothing from the property of the corporation. In the words of the court:

"'A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interest of the shareholders. Its property is not diminished and their interests are not increased. . . . The proportional interest of each shareholder remains the same. The only change is in the evidence which represents the interest, the new shares and the old shares together representing the same proportional interest that the original shares represented before the issue of the new ones.'

"The definition of the later law may suffice to control the discretion of the tax collectors, but it will not persuade the court that income is principal, or that principal is income, because they are so defined by a statute. If either can be taxed under the name of the other, then it can be taxed under both names, with the result of double taxation and deprivation of property without due process of law. The statute will signify as little to the court as the court's decision signifies to the tax authorities. If anything is collected under this definition, it will be repaid, unless the court shall change its mind regarding the constitutional argument. The lower

court decided that stock dividends were taxable as income under the 1913 statute, and the Supreme Court overruled it. The lower court also decided that the 1913 statute was constitutional with that construction regarding the taxability of stock dividends as income. Before the Supreme Court the Government would have abandoned the argument for the constitutionality of the 1913 statute as thus construed, but was not allowed to do so. The Supreme Court said that while the Treasury kept the tax money it was to be held to the position it took originally as to the constitutionality of the statute as thus construed.

"When the tax officers go into the Supreme Court with the 1916 statute they are sure to be met with the argument of Mr. Hughes, supported by the decision which already is against them. The statute upon which they rely is to blame, not the tax collectors. Least of all are the taxpayers to blame for disputing the statute. The statute is obnoxious to most of the canons of taxation. In the instant case the attempt was to collect a tax upon $417,450, which the court said Mr. Towne did not receive. His dividends were not increased, his property was not increased, and yet he was to be taxed upon a half million of printed paper. There is $100,000,000 of such paper now claimed to be taxable, although the tax is brand new. The result of maintaining the constitutionality of the statute would be to overturn settled principles of law and finance."

This attitude is substantially the same as that taken by Archibald R. Watson, former Corporation Counsel of New York, in an interview reprinted below.

"Sees Stock Dividend Free From Taxation" [1]

"Archibald R. Watson, former Corporation Counsel, a member of the law firm of Barber, Watson & Gibboney, said yesterday that the recent income tax decis-

[1] *New York Times*, January 13, 1918.

ion of the United States Supreme Court in the case of *Towne vs. Eisner* would precede in authority any order of any Federal department. Mr. Watson was asked to comment on the decision and on the bulletin of the Treasury Department instructing Internal Revenue Collectors to continue to assess and collect income taxes upon stock dividends, because his firm, as amicus curiae, submitted a brief when the case was in the Federal District Court.

"Mr. Watson said that the Commissioner of Internal Revenue apparently regarded the Supreme Court decision as inconclusive. He based this statement on the instructions to Collectors of Internal Revenue to treat as income all stock dividends declared and paid out of earnings accrued since March 1, 1913.

"Collector Edwards, in a recent statement, called attention to the opinion of the United States Supreme Court that a stock dividend declared by a corporation Jan. 2, 1914, under the act of Oct. 3, 1913, was not properly regarded as income. He thought, however, that it did not necessarily follow that no stock dividends were to be held taxable under the provisions of the acts of Sept. 8, 1916, and Oct. 3, 1917. He recalled that the act of 1913 was the only one before the court, and that it contained no provisions expressly providing for treating stock dividends as income."

Opinion of the Court

"Mr. Watson declared that the opinion of the Supreme Court was both a 'decision upon particular facts and an enunciation of principles,' and that a fair deduction of the language of the court was 'that a stock dividend based upon earnings' was not taxable.

" 'The first income tax law,' said Mr. Watson, 'which was passed Oct. 3, 1913, was made retroactive to March 1st of that year, the constitutional amendment authorizing a direct tax on incomes not having become effective

until Feb. 28, 1913. Of course, the decision of the United States Supreme Court is conclusive and final as to everything actually decided or necessarily involved in the decision.

" 'The bulletin issued by the Treasury Department claims that in the case of *Towne vs. Eisner* the Supreme Court only held that under the law of Oct. 3, 1913, a stock dividend declared in January, 1914, was not properly regarded as income. But *Towne vs. Eisner* was both a decision upon particular facts and an enunciation of principles. Limited to its special circumstances, it is not of wide interest, because of the comparatively few persons in like situation. But as a declaration of fundamentals it is sure to have important consequences.

" 'Though the case does not expressly so hold, a fair deduction from its language is that a stock dividend, based upon surplus earnings, which have in good faith been carried into capital, is not taxable as income under the Sixteenth Amendment to the Constitution; that is to say, a further constitutional change would be required to authorize such a tax. In this connection Mr. Justice Holmes reaffirms the doctrine of the Gibbons case, decided in 1890, (136 U. S. 549), which did not, however, involve the taxation of stock dividends, quoting the following:

" 'A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interest of the shareholders. Its property is not diminished and their interests are not increased. . . . The proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original shares together representing the same proportional interest that the original shares represented before the issue of the new ones.'

"'Justice Holmes' opinion concludes with the sentence:

"'What has happened is that the plaintiff's old certificates have been split up in effect and have diminished in value to the extent of the value of the new.

"'A tax upon the certificates, therefore, would be a tax on capital and not upon income, and as such not authorized by the Sixteenth Amendment.

"'Under the present income tax law, as amended, stock dividends are declared to be subject to tax as income in the hands of the stockholder, but only at the income tax rates in force at the time the profits so distributed were earned. Under the reasoning of the opinion in the *Towne vs. Eisner* case, however, such dividends would not be taxable at all, because, in effect, only a splitting up of the stockholder's old certificates, or a change in the evidence representing the stockholder's interest.

May Hypothecate Stock

"'It may be anticipated, therefore, that stock dividends in preference to cash dividends will be more popular than ever during the coming year. The recipient of a stock dividend may hypothecate the stock as security for a loan without being taxed upon the amount so borrowed, and would even be allowed as a deduction interest paid upon such a loan, under the provisions of the law as it stands:

"Of course, if the recipient of a stock dividend should sell the stock so received, together with the original stock held by him, any profit thus realized over and above the original cost of the stock, in respect of which the stock dividend was declared, would probably be taxed as income. But short of this there would appear to be considerable advantage in dividend distributions of stock in preference to cash by corporations.

"'It is true, as pointed out in the recent bulletin of

the Treasury Department, the act of October 3, 1913, does not contain an express provision for the taxing of stock dividends. Later acts, that is, the act of September 8, 1916, and of October 3, 1917, do contain such provisions. The act of October 3, 1913, purports, however, to tax dividends, without distinguishing between cash dividends and dividends paid in stock, and the Treasury Department ruled that stock dividends constituted taxable income to the same extent as cash. If the Commissioner of Internal Revenue is in doubt about the matter, the sooner a test case is brought the better for all concerned. But there can be little doubt that the principle enunciated by the Supreme Court in the case of Towne *vs.* Eisner will be held to prevent the taxation of stock dividends, whether under the income tax law of October, 1913, or later enactments.'"

The position of the taxpayer.—Until the matter of the taxability of stock dividends under the 1916 and 1917 laws is finally passed on by the courts, the individual taxpayer will be compelled to conform with the requirements of the Treasury Department.

Those taxpayers who have received in 1917 stock dividends representing earnings of corporations earned subsequent to March 1, 1913, should include such amounts in their returns of income, and attach to such return of income a statement fully setting forth the facts. Such returns should be filed under protest, until such time as it is seen what will be the decision of the court with reference to the acts of 1916 and 1917. In case the position of the Department is not upheld by the Court, the taxpayer will then be able to obtain a refund of any such taxes paid under protest.

Income on building and loan shares.—It is held that amount credited to shareholders of building and loan associations, when title to such credit passes to the shareholder at the time of the credit, has a taxable status for the normal and additional tax as for the year of the credit.

Where the amount of such accumulations does not become available to the shareholder until the maturity of a share the amount of a share in excess of the aggregate amount paid in by the shareholder is income to be accounted for as for the year of the maturity of the share for both the normal and additional tax.

CHAPTER IV

INDIVIDUAL INCOME TAX

DEDUCTIONS FROM GROSS INCOME

Deductions from gross income.—The income tax is based upon the net income of the individual making the return. After computing his gross income the individual will calculate the deductions allowed him by law and by subtracting these deductions from his gross income will arrive at his net income.

Deductions allowed in computing net income of citizens and residents of the United States.—The Income Tax law, sec. 5, provides, that in computing net income in the case of a citizen or resident of the United States—

"(a) For the purpose of the tax there shall be allowed as deductions:

"First—The necessary expenses actually paid in carrying on any business, or trade, not including personal, living or family expenses.

"Second—All interest paid within the year on his indebtedness except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title.

"Third—Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes) or of its Territories, or possessions, or any foreign country, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits.

"Fourth—Losses actually sustained during the year, incurred in his business or trade, or arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise:

"Provided, that for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained.

"Fifth—In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom.

"Sixth—Debts due to the taxpayer actually ascertained to be worthless and charged off within the year.

"Seventh—A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade.

"Eighth—(a) In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained, not by the flush flow but by the settled production or regular flow.

"(b) In the case of mines a reasonable allowance for depletion not exceeding the market value in the mine, of the product mined and sold during the year for which the return is made.

"Ninth—Contributions or gifts actually made within the year to corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or to societies for the prevention of cruelty to children or animals, no part of the net income of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's taxable net income as computed without the benefit of this paragraph. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury."

Deductions allowed in computing net income of non-resident aliens.—As to *non-resident aliens* the law allows the following deductions:

"First—The necessary expenses actually paid in carrying on any business or trade conducted by him within the United States, not including personal, living or family expenses.

"Second—The proportion of all interest paid within the year by such person on his indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) which the gross amount of his income for the year derived from sources within the United States bears to the gross amount of his income for the year derived from all sources within and without the United States, but this deduction shall be allowed only if such person includes in the return required by section eight all the information necessary for its calculation.

"Third—Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, paid within the United States, not including those assessed against local benefits.

"Fourth—Losses actually sustained during the year, incurred in business or trade conducted by him within the United States, and losses of property within the United States arising from fires, storms, shipwreck,

or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise:

"Provided, That for the purpose of ascertaining the amount of such loss or losses sustained in trade, or speculative transactions not in trade, from the same or any kind of property acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss or losses sustained.

"Fifth.—In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom in the United States.

"Sixth.—Debts arising in the course of business or trade conducted by him within the United States due to the taxpayer actually ascertained to be worthless and charged off within the year.

"Seventh.—A reasonable allowance for the exhaustion, wear and tear of property within the United States arising out of its use or employment in the business or trade.

"Eighth.—(a) In the case of oil and gas wells a reasonable allowance for actual reductions in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow.

"(b) In the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made.

"Provided, That when the allowance authorized in caption "Eight" (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance for depletion shall be made.

"No deduction shall be allowed for an amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate.

"And no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made."

The deductions allowed to non-resident aliens it is seen are practically the same as those allowed to citizens and residents of the United States with the exception that the deductions of non-resident aliens are limited to items arising within the United States, and this is for the reason that non-resident aliens need report only such income as arises from sources within the United States. Any special distinctions between residents and non-resident aliens are considered under the various headings.

Necessary business expenses actually paid allowed as a deduction from income.—The taxpayer may first deduct from gross income all items of business expense that have actually been paid within the calendar year and that have been incurred in the carrying on of an individual business. Family or living expense cannot be deducted.

If an individual keeps his books on an accrual basis in which he charges expenses when they are incurred (instead of when they are paid) he may deduct the business expenses that have been incurred during the year, instead of the amount actually paid during the year. But if an individual reports his expenses as incurred he must also report his income as earned. Otherwise his records would come under the heading of "records which do not clearly reflect his income," and would not be acceptable as a basis from which to make his return.

Expenses of a partnership should not be included, as they are taken into consideration in arriving at the figure "Net Income from Partnership," which net figure is reported on the income side of the return.[1]

All expenses incurred in earning taxable income are deductible.—Expenses incurred in earning income which is exempt are not allowable deductions. But expenses incurred in the earnings of taxable income are deductible. Deductible expenses therefore include all amounts paid by a farmer for labor in preparing his land for a crop and the cultivation, harvesting, and marketing of the crop; the cost of the seed and fertilizer used; the amounts expended for labor in caring for live stock; the cost of the feed, the cost of stock purchased for the purpose of resale (it should be understood, that if such cost is claimed as a deduction, the entire proceeds received upon a sale of the stock is to be returned as income); the amounts actually paid in mak-

[1] See pages 71, 74.

ing repairs to farm buildings (but not to the dwelling house of the individual); repairs to fences, farm machinery, etc. The cost of materials for immediate use, of farm tools which are used in the course of a year, and the amount of rent paid for a farm itself may also be deducted.

A merchant may deduct as expenses the amounts paid for advertising, hire of clerks and other employees, the cost of light, heat, water, telephone, etc., used in or at his place of business, all freight bills, the cost of operating delivery wagons, trucks and the repairs to the same.

If the individual employs a minor son or daughter to assist him in his business and to whom he pays a salary or wages for such assistance, such amount paid is *not* a proper deduction as an expense. If, however, the son or daughter has attained his or her majority the amount of compensation paid for such services may be claimed.

Amounts expended by a business man in entertaining out-of-town customers or prospective customers are a proper expense, provided the sole purpose of the business man in making such expenditures is to cultivate the good will of his customers and secure an increase in trade. Such expenditures may be looked upon in the same light as sums paid in advertising the business or as other selling expenses.

The individual engaged in a business and keeping accurate records will have to be able to determine most of the deductible expenses of his business. Some important questions will arise as to whether or not certain items are allowable as deductions. These questions are taken up in detail under Corporation Deductions, in a later chapter. It is the salaried or professional man whose deductible expenses are fully treated here.

Personal, family and living expenses are not deductible.—Personal, family or living expenses are, by provision

of the law, not deductible. Alimony has been definitely held as a non-deductible personal expense of the person paying it. All payments which represent savings investments, such as building and loan payments, pension fund payments, life insurance premiums, etc., are not deductible. Clothing as a general rule is considered as a personal expense. Actors and actresses, however, are allowed to deduct the cost of stage costumes if of use only during the current year.

Wages paid domestic servants, etc., not deductible.—The wages of domestic and other servants, such as maids, valets and chauffeurs of pleasure cars are considered personal expenses and are not deductible.

Rent of living quarters.—Rent of living quarters may not be deducted. If an individual owns his own home he is *not* required to include in his income the rental value of the property. On the other hand, he is not allowed to deduct the cost of maintenance of the property, other than taxes, and interest on bonds or notes secured by a mortgage on the property.

Where a building is occupied by both a tenant and the landlord, the expenses of maintenance should be separated as between the tenant's and the owner's portion of the building. The expenses applicable to the tenant's portion of the building are an allowable deduction. Where the expenses are not directly applicable to either portion of the building they should be prorated on the basis of the rental values of the respective portions.

Where a person uses his residence both as a home and as an office, as is very common among physicians and dentists, he may deduct as a necessary expense of his business the rental value of such rooms as he uses solely as an office, provided he pays rent.

Automobiles used for business.—The cost of upkeep of an automobile used for business purposes is an allowable deduction.

This deduction is allowable even though the machine may be occasionally used for pleasure. The fact that a physician occasionally takes his family out for a pleasure trip does not affect the fact that the upkeep of the car is a necessary expense of his profession. But the total upkeep should not be charged as a business expense. Only that proportion of the expenses which the business trip mileage bears to the total mileage, including business and pleasure, should be deducted.

Membership dues.—Membership dues in a club or other society are not deductible if the organization is for social purposes.

Membership dues in a trade or technical association, such as Trade Union, Chambers of Commerce, Medical Societies, etc., are deductible as necessary expenses.

Technical magazines and books.—The same rule applies to magazines. The cost of general magazines and newspapers is considered as a personal expense. The cost of technical and trade magazines is a deductible expense.

As to books, the original cost of either class of books is not a deductible expense. The depreciation on technical books is an allowable deduction under the heading "depreciation."

The premium on a fidelity bond is an allowable deduction.—If an employee is required to furnish bond and pay the premium on such bond, as a necessary incident of his employment, the premium on the bond will constitute an allowable deduction in computing net income.

Traveling expenses.—The general rule is that expenses incurred in traveling from place to place in the prosecution of business may be deducted. A salesman working on a commission basis may deduct railroad fares, carfare, etc. He may deduct the cost of lodging, but

not the cost of his meals, the distinction being that he presumably maintains a home, and that the cost of lodging is an added expense made necessary to earn his income.

Commutation to and from work not a deduction.—A person engaged in business in New York, for example, and residing in the suburbs is not allowed to deduct the commutation or the fare to and from his business. This expense is a part of the living expenses.

The landlord's expenses in connection with rented property are deductible.—Deduction may be claimed on account of any expense incurred in the maintenance or use of property for rental purposes, including amounts paid for repairs, insurance, fuel, light and water, and janitor and elevator service. A reasonable allowance may also be deducted for depreciation of the property. This deduction is provided for under a separate heading.[1]

Commissions paid to real estate agents.—Commissions paid to real estate agents for the collection of rents and the management of property is a legitimate business expense, and may be deducted. But commissions paid for the purchase of property are not deductible expenses. Such commissions should be added to the cost of the property, and commissions paid for the sale of property should be deducted from the selling price in ascertaining the gain or loss on the sale.

Insurance premiums.—Premiums paid for fire insurance on a building which is rented or leased to secure an income may be deducted. If the building or property is occupied by the owner as a dwelling, such insurance charges are not allowable deductions.[2]

Insurance on furniture in an individual's home is a personal expense, but insurance on office furniture

[1] See page 122.

[2] If part of the building is rented, or is used by the owner for business purposes, apply the rules found on page 104.

would be a business expense. The cost of all fire, burglary, plate glass, sprinkler leakage and other forms of insurance on *any* property used in the business of the individual is a business expense. This also includes insurance on the live stock of a farmer, or on a truckman's horses.

Life insurance premiums are not deductible.—Life insurance premiums paid are not an allowable deduction. The amount of premiums paid may, however, be deductible from the proceeds of the policy.[1] This applies to insurance upon the life of an employee, payable to the employer, and to insurance upon the life of a partner payable to the partnership, as well as insurance upon the life of an individual.

Liability insurance.—Amounts paid by individuals in business as insurance against a liability which if actually incurred would be deductible as an expense of business, are permitted as a deduction.

Assessments paid on stock of a corporation are not deductible expenses.—Assessments paid by a stockholder on stock he holds in a corporation or other business association are not allowed as a deduction in the individual's return. Such assessments are considered an investment of capital and not an expense. This is held true, whether the assessment is legally levied by the corporation or is simply a voluntary payment of the stockholders to make good a deficit. The amount of the assessment may be added to the cost of the stock in determining the profit or loss from its sale.

Deductions from income allowed to farmers.—The farmer may deduct from gross income the legitimate expenses incident to the production of farm products. Deduction may be claimed in the return of income

[1] The rulings of the Department up to September, 1916, permitted the deduction of insurance upon the lives of employees, payable to employers, and upon the lives of partners, payable to the partnership. Premiums which were deducted as an expense of business under these rulings may not be deducted again from the proceeds of policy.

for the tax year in which the right to such deductions arises, although the products to which such expenses are incident may not have been sold or exchanged for money, or a money equivalent, during the year for which the return is rendered. However, when farm products are held for favorable market prices, no deduction on account of shrinkage in weight or physical value, or losses by reason of such shrinkage or deterioration in storage is allowed, as the reduction in value is reflected in the sales price received.

The cost of live-stock purchased for resale is an allowable deduction under the item of expense, but money expended for stock for breeding purposes is regarded as capital invested, and the amounts so expended do not constitute allowable deductions except where stock after being purchased dies from disease or injury or is condemned by the public authorities. In such a case the farmer may deduct as an expense the actual purchase price of such stock, less any depreciation which he may have previously claimed, or less any insurance which he may have collected.[1]

Loss not to be deducted if farm is for pleasure.—A person cultivating or operating a farm for recreation or pleasure, on a basis other than the recognized principles of commercial farming, the result of which operations is a continual loss from year to year, is not regarded as a farmer. In such cases, if the expenses incurred in connection with the farm are in excess of the receipts therefrom the entire receipts from sale of products may be ignored in rendering a return of income; and the expenses incurred being regarded as personal expenses will not constitute allowable deductions in the return of income derived from other sources.[2]

[1] The farmer is allowed, as an expense of business, the premium so paid for insurance.

[2] However, if the farm is operated at a profit and not a loss, the entire receipts should be included as income, and the expense of such farm would constitute a proper deduction.

Interest.—Under this caption should be included *all interest paid* (or accrued, if books are kept on the accrual basis), during the year on any indebtedness, except that incurred in the purchase of securities the interest on which is exempt from the income tax.

The interest on bonds of the second Liberty Loan, which includes both the first conversion 4s, and the second 4s, is exempt from the surtax only to the extent of the interest on $5,000 par value of the bonds. The interest on indebtedness incurred in the purchase of second Liberty Loan Bonds should not be deducted under this section, but it is deductible[1] in computing the super-tax. (T. D. 2541.) The interest will also be an allowable deduction in computing the income subject to the Excess Profits tax. It will be noticed that an individual holding an amount up to $5,000 of second Liberty Loan Bonds will be allowed as deductions in computing the surtax and Excess Profits tax the interest on the bonds and interest on loans made to purchase them.

Interest paid to purchase stock of corporations which pay dividends may be allowed as an item of expense in the individual's report, although the dividends themselves are not subject to normal tax in the hands of the individual, they only bearing super-tax. However, the corporation before distributing dividends is assessed a normal tax upon its net income, and from the balance the dividends are paid, and it therefore follows that the interest paid by an individual on indebtedness incurred to purchase stock of a corporation is a proper deduction in his income tax report.

The amount of interest that may be deducted by a non-resident alien is limited by Sec. 6, subdivision 2, of the Income Tax law to: "The proportion of all interest paid within the year by such person on his indebtedness which the gross amount of his income for the

[1] See Rate of Tax—Deductions from Super-Tax.

year derived from sources within the United States bears to the gross amount of his income for the year derived from all sources within and without the United States, but this deduction shall be allowed only if such person includes in the return all the information necessary for its calculation."

For example, a non-resident alien has a total income of $100,000, $10,000 of which is from sources within the United States, and he pays out $1,000 in interest. He will be allowed as a deduction 1/10 $\left(\frac{10,000}{100,000}\right)$ of $1,000, or $100. He will be allowed this deduction only if he includes in his return a statement of his total income from all sources and also the total amount of interest paid.

Taxes.—The individual may deduct all taxes paid with the exception of income and excess profits taxes levied by the United States and assessments levied for local benefits. Assessments levied for local benefits are held to include all taxes paid pursuant to assessments levied by special districts, such as irrigation, reclamation, drainage districts, etc., for sidewalks in cities, street extension, grading, paving, etc.

While the individual may not deduct as an expense any excess profits taxes paid, his net income as reported to the Government will be credited with the amount of any excess profits tax imposed by act of Congress and assessed for the same calendar year or fiscal year upon the taxpayer. In the case of a partnership, each member will be credited with his proportionate share of the excess profits tax imposed upon the partnership.

The reason for this distinction between deduction and credit is clear. The excess profits tax is based upon the *net income* and therefore cannot be deducted in computing the net income. The law does not intend a double taxation and accordingly allows a credit for the amount of excess profits tax in imposing the Income Tax.

It is to be noted that the act of September 8, 1916, as amended October 3, 1917, distinctly specified that income taxes are not to be included as a deduction. That means that as the amendments are retroactive to January 1, 1917, but to that date only, that income taxes actually paid during 1917 for the earnings of 1916 are not to be deducted in the return of income for 1917. The amendment in question applies only to the business man or individual who keeps his books of accounts on the cash receipt basis.

Section 8, subdivision (g) of the act of September 8, 1916, allows for the rendering of reports by an individual on a basis other than "cash" unless such basis does not truly reflect the true earnings for the taxable period. Therefore it follows that those individuals who kept their books of accounts on the "accrual" basis for the year 1916 and included as part of the taxes due, the 1916 income tax, although it was not paid until later in 1917, were allowed as a deduction the income taxes for the year 1916 paid during 1917.

Of course this does not apply to 1917 or subsequent income taxes.

Inheritance tax not deductible.—Inheritance taxes are charges against the corpus or capital of the estate and are not deductible either by the estate or by a beneficiary.

This applies to State inheritance taxes as well as to the Federal Estate Tax.

Taxes on property used as a residence may be deducted.—The fact that the property on which the tax is assessed is used as a residence does not prevent the deduction of the tax. In this respect the man who owns his home has an advantage over the one who pays rent. The owner is not required to report as income the rented value of the property, yet he may deduct as expenses the taxes paid on such property and any interest

paid on mortgages outstanding against the value of the property.

The rent payer, on the other hand, cannot deduct as an expense the rent paid for the residence he occupies.

Taxes paid by bank on stock held by individual.—Taxes assessed against the stockholders of a bank and paid by the bank in behalf of the stockholders do not constitute an allowable deduction from the gross income of the bank, but do constitute an allowable deduction as taxes paid in the return of the individual. Of course the individual must also report as income from dividends the amount of the taxes paid by the bank in his behalf. If the stock is owned by one stockholder at the time the tax is levied and by another at the time it is paid deduction may be made by the holder of the stock at the time that the taxes were paid.

To illustrate, *A* owns a number of shares of stock which he holds at the time the taxes are assessed against the stockholders of a bank. *A* sells to *B* prior to the payment of the tax by the bank. *B*, holding the stock at the time the taxes were paid by the bank, would be allowed the deduction. However, taxes assessed while the stock was in *A's* hand, which became due and payable prior to date of sale to *B*, may be deducted by *A*.

As has been already pointed out, taxes paid by a bank for the stockholder should be considered an additional dividend by the stockholder, and included in the return of income of the one allowed the deduction.

Customs duties may be deducted.—Customs duties paid during the year are allowable if they are paid on merchandise imported for business purposes. The duty would then be considered part of the cost price of the merchandise. If, however, the duty was paid on personal belongings or merchandise to be used for purposes other than for business, such duty would be allowed as a deduction, because it is an item of taxes.

Contributions to charitable organizations.—Contributions to charitable and other similar organizations may be deducted only to the extent of 15 per cent of the taxable net income of an individual as computed without deducting the amount of such gifts. An individual having a net income of $100,000 could deduct such gifts or contributions to the extent of $15,000. This provision is a new feature in the law; the 1916 act as originally enacted specifically stated that gifts of any sort were not deductible. The change is undoubtedly due to the enormous amounts contributed to the Red Cross and other war charitable organizations. Deductible contributions include contributions made to the Red Cross, Y. M. C. A., Knights of Columbus War Fund, for the furtherance of any religious activities, including the construction of a new church, and to the associated charities of one's home city. Contributions made toward the support of a needy family cannot be included, as contributions made to individuals do not constitute allowable deductions, which deductions are limited to contributions made to organizations or associations. Of course, the association need not be a duly incorporated organization.

A non-resident alien is not allowed to deduct gifts or contributions made to charitable organizations, etc., neither are any corporations either domestic or foreign.

BUSINESS LOSSES

Necessity for distinguishing "business" losses.—Under the Income Tax law, as in effect for the years 1913 to 1915, inclusive, no deductions were allowed except for losses incurred in business, but all profits from sources outside the business were included as income. As amended in 1916, the law permits the deduction of losses outside of business but this deduction is limited to the amount of profits derived from similar sources during the year. It is therefore important to know just what the Treasury

Department's definition of business is, and what losses it will consider as "losses incurred in business or trade."

Definition of "business" and "trade."—Business has been defined by the Treasury Department as "That which occupies and engages the time, attention and labor of any one for the purpose of livelihood, profit, or improvement; that which is his personal concern or interest; employment, regular occupation, but it is not necessary that it should be his sole occupation or employment."

The Department further states that: "The term 'in trade,' as used in the law, is held to mean the trade or trades in which the person making the return is engaged; that is, in which he has invested money otherwise than for the purpose of being employed in isolated transactions, and to which he devotes at least a part of his time and attention. A person may engage in more than one trade and may deduct losses incurred in all of them, provided, that in each trade the above requirements are met. As to losses on stocks, grains, cotton, etc., if these are incurred by a person engaged in a trade to which the buying or selling of stocks, etc., are incident as a part of the business, as by a member of a stock, grain, or cotton exchange, such losses may be deducted.

"A person can be engaged in more than one business but it must be clearly shown in such cases that he is actually a dealer or trader or manufacturer, or whatever the occupation may be, and is actually engaged in one or more lines of recognized business before losses can be claimed with respect to either or more than one line of business."

An individual may deduct as a loss of business, his share of the loss of any partnership of which he is a member.[1] If, however, he owns an interest in a corporation he is not allowed to deduct the decrease in the value of stock holdings unless the loss is determined by a sale of the stock and even then his loss is treated as a loss in a stock transaction and not as a loss in business.[2]

[1] In determining the partners' distributable profits or losses of a partnership that does not own a membership in a stock exchange, or if dealing in securities does not form part of its regular business, losses actually sustained in stock transactions entered into for profit may be deducted in an amount not exceeding the profits derived from similar transactions entered into for profit. Of course if a partnership is engaged in the business of purchasing and selling securities, or owns a membership in a stock exchange, the full amount of losses sustained on such transactions may be deducted.

[2] The fact that the individual cannot dispose of the asset will not alter the above rule. If an individual holds some worthless mining stock he

But if he is a dealer in securities he may deduct losses on stock, even before the stock is sold.

As far as transactions in stocks, etc., are concerned, the Department has not insisted that the individual or partnership be a member of the exchange in order that the transactions may constitute a business, but it has held that he or the partnership must have the standing of a recognized dealer in securities or in commodities.

It is important to remember that, for the purpose of ascertaining whether a person is a dealer in securities, etc., the individual and the partnership of which he is a member are treated as separate entities. The mere fact that an individual is a member of a partnership engaged in dealing in securities, does not permit the individual to deduct losses resulting from stock transactions on his own account unless he, individually, is a recognized "dealer."

To each return there should be attached a statement of each loss containing the following information:

a. What the loss consisted of.

b. When it was actually sustained.

c. How it was determined to be a loss.

d. If sustained by loss of property acquired prior to March 1, 1913, the fair market price or value as of that date and how such value was determined.

Losses by theft.—Losses of any assets by theft, not entirely compensated for by insurance or otherwise, are a proper deduction. This includes losses of personal jewelry, pleasure or business automobiles and securities. If, however, the theft represents a loss of merchandise or the stock in trade of the individual, and the individual computes his income on the basis of an annual inventory, then the amount of loss cannot be claimed, inasmuch as such loss will be reflected in the reduced inventory at the time inventory is taken at the end of

must actually sell the stock before he is allowed to deduct the loss and then be subject to the limitations of the taxing act.

the year. In the latter case, if the loss has been covered by insurance, the insured should report the insurance collected as income. But if he has not previously deducted the premiums in each year as they were paid, he need report as income only the difference between the amount collected and the total insurance premiums paid. The loss offsetting the insurance collected will be shown either in the reduced gross sales or in the reduced inventory at the end of the period.

Losses by fire or the elements.—Losses by fire of any asset of the individual, including even his own residence or a pleasure automobile, and not compensated for by insurance or otherwise are a proper deduction.

Losses of crops, either growing or harvested, or of fruit trees or rose bushes of a grower through frost, fire, etc., are not deductible as an expense. This is for the reason that the *actual* cost of harvesting or producing that which has been destroyed is allowed as an expense of business in the year in which the expenses were incurred, and to permit the deduction of the value of the crops lost, in addition to the deduction of the expense of creating that value, would result in a double deduction, manifestly unfair to the government.

If the loss has been covered by insurance, the insured should report the insurance collected as income. If he has not previously deducted the premiums in each year as they were paid, he need report as income only the difference between the amount collected and the total insurance premiums paid.

Losses through accidents.—Amounts paid by an employer for an accident an employee sustains are deductible expenses. Likewise, amounts paid to persons who are injured in the operation of the plant or equipment of a business are deductible. Thus, if an automobile is operated for business and runs over a person, the amount paid to such a person is a deductible expense.

But if the automobile were operated for pleasure, the amounts paid for an injury resulting from an accident cannot be deducted even though they represent amounts paid through judgments rendered.

LOSSES OTHER THAN FROM BUSINESS

Losses other than business losses.—The allowance of losses resulting from transactions not connected with the individual's trade or business is subject to two restrictions.

1. The loss must be the result of a transaction entered into for profit.

2. The loss may be deducted only if there is at least an equal amount of income from transactions entered into for profit, and not connected with the individual's trade or business.

Losses sustained through fire, storm, shipwreck, or by theft are not included under this heading. Such losses, not compensated for by insurance, may be deducted without any limitation.

The loss must be the result of a transaction entered into for profit.—To be deductible, such losses must arise from transactions actually entered into for profit and not for any other purpose. If a transaction is entered into merely for pleasure and not for profit, losses, if incurred, could not be deducted.

The loss may be deducted only as an offset against profits from similar transactions.—The amount that may be deducted as losses other than from business is limited to the amount of profit during the year from similar transactions.[1] This limitation does *not* mean that a loss on one stock transaction may be offset only by the profit on another stock transaction. It does, however, mean

[1] To come within the definition of a "similar transaction" the profit must have been realized in the same manner as that in which the loss was sustained, i.e., if the loss was sustained due to purchase and sale of an asset, then the profit to offset such loss must have been realized through a purchase and a sale.

that a loss on a stock transaction cannot be offset against any income, but against the profit from another transaction entered into for profit outside of the trade or business of the individual. A loss on a stock transaction cannot be offset against income from rent, interest on bonds, dividends on stocks, or similar items. Such items do not come under the classification of "transactions entered into for profit but not connected with the trade or business of the individual." But the loss on a stock transaction can be deducted from the profit on a cotton or grain market operation, or from the profit on a sale of real estate, or from the profit on a foreign exchange speculation.

A is engaged in the manufacturing business. In 1914 he invested $20,000 in real estate, but as a result of local conditions the rental return decreased to such an extent that in 1917 he sold this property for $14,000, thereby incurring a loss of $6,000. Inasmuch as he had no income from a similar transaction entered into for profit, and as the real estate business was not his recognized line of business, *A* would not be allowed to charge off in 1917 the loss of $6,000 so sustained.

Losses due to destruction of building.—Losses due to the voluntary removal or destruction of buildings made necessary by improvements to the property, as when an old building is destroyed and a new building erected, are a charge to the cost of the new building. In no case may such "losses" be charged as a loss in determining net income. The amount which may be added to the cost of the new building is the difference between the cost of the building removed and the amount of the depreciation reserve already provided for depreciation of the old building. The individual therefore does not receive any credit against his net income on account of such a loss unless the new building is sold. In the case of a sale of the new building, the loss or profit on the transaction will be the difference between

the selling price of the new building on the one hand, and the cost of the new building plus the value of the old building at the time it was destroyed, on the other hand.

Of course, in calculating the depreciation on the new building, the owner may use as the basis of depreciation calculations the construction cost of the new building plus the value of the old building at the time it was destroyed.

The following will illustrate exactly what may be done in the above cases. *A* constructs a building originally costing $300,000, and having an estimated life of 30 years. At the end of 20 years he tears down the old building, on which he has already deducted $200,000 depreciation, and erects a new building at an additional cost of $900,000, with an estimated life of 40 years. The apparent loss sustained in the destruction of the old building ($100,000) may not be deducted as a loss. This loss of $100,000 is charged to the cost of the new building, and the following year *A* may deduct depreciation on a valuation of the new building of $1,000,000. He may therefore deduct $25,000 depreciation each year.

If *A* later sells the new building for $1,400,000 his profit is $400,000, *not* $500,000. If *A* sells the new building for $900,000, his loss is $100,000.

Losses sustained by the destruction of unsafe or insanitary buildings ordered destroyed by the authorities of a municipality cannot be claimed as a deduction, either as a loss or as depreciation.

But losses due to the destruction of a building by fire or the elements are properly deductible, to the extent that they were not covered by insurance. This is true, even though the building is not used for business purposes. And the amount of loss sustained in this case is *not* limited to "the gains from similar transactions."

Losses on stock transactions.—The method of determining losses on stock transactions is as follows: A stockholder's investment is in the stock of a corporation. If he disposed of his stock for more than its fair market value on March 1, 1913, or its cost if acquired since that date, the profit realized must be returned as income; if he disposes of it at a loss, the loss sustained is deductible from gross income within the limits of the taxing act. In computing the profit or loss sustained there must be taken into account dividends paid from reserves accumulated prior to March 1, 1913, which were not returned as income for the year in which received.

Losses on stock transactions may be deducted in full by an individual:

1. If he is a member of a stock exchange.
2. A licensed or recognized broker engaged in buying and selling securities for others.
3. If the buying and selling of securities form a part of his regular business or trade.[1]

BAD DEBTS

Bad debts deductible.—The taxpayer is allowed to deduct only such debts as are actually ascertained to be worthless and charged off within the year. An individual is not allowed to deduct an estimated amount to cover losses that *may* be charged off in the future, such as "reserves for bad debts." But amounts paid as premiums for credit insurance are deductible.

Debts which arise from items of income (i.e., accounts receivable from sales, etc.) and which later prove to be worthless, will not be allowed as a deduction, unless the income which they represent is included in the return, or has been included in a return of a previous year. Thus an individual would not be allowed to

[1] See also the treatment of this subject under Corporation Deductions in a later chapter, p. 219. See also p. 60.

deduct as a bad debt unpaid salary, unless he had kept his books in such manner as to include the salary as income when it was earned.

Debts due and payable prior to March 1, 1913, and not ascertained to be worthless prior to that date, are proper deductions in the year when they are actually ascertained to be worthless, and are charged off as uncollectible.

Where the debtor is an *individual,* or partnership, the Treasury Department does not require the creditor to secure a judgment against the debtor and proceed upon the judgment, before allowing him to deduct the debt. It does, however, require him to show, beyond a reasonable doubt (taking into consideration the time the debt has run and the financial conditioning of the debtor), that the debt is worthless and uncollectible.

Where the debtor is a corporation possessed of assets no deduction can be claimed until the corporation's affairs are finally closed and its receiver in bankruptcy discharged.

Where a creditor makes a compromise agreement or common law settlement with the debtor and accepts a part of the debt as full payment releasing the debtor from payment of the balance, he may deduct the unpaid portion as a bad debt. The same rule applies if the creditor accepts a composition settlement in bankruptcy. But if *A* claimed that *B* owed him $1,000, and *B* contested the claim, but agreed to pay $500 to settle it, *A* could not deduct the balance which he contended was due him. This case differs from the preceding one in that there is a *contest* as to the amount of the indebtedness.

If the debtor corporation has no assets whatsoever and it is definitely known that nothing whatsoever can be collected from the debtor itself or any person connected with it, a creditor need not go to the expense of instituting bankruptcy proceedings in order to es-

tablish his right to claim the worthless debt as a deduction.

Should an individual endorse a note and later be obligated to make good the payment of the instrument by reason of the insolvency of the maker, he may charge off the amount involved as a bad debt after he has actually paid it, unless at the time of his endorsement, he was aware the maker was insolvent.

Bad debts arising from transactions not connected with business.—Any bad debt is deductible; it is not necessary that it should be one which has arisen out of transactions connected with the individual's trade or business. Thus, a personal loan which proves uncollectible is a proper deduction. The purchase price of a bond or note purchased for investment (and not for speculative purposes) which proves to be worthless, is deductible. There is absolutely no limitation imposed on the amount of bad debts which may be deducted.

Losses sustained incident to foreclosure of a mortgage.—A loss sustained by a mortgagee in the foreclosure of a mortgage is deductible, providing the debt represented by the bond or note of the mortgagor is uncollectible.

DEPRECIATION

Depreciation deductible.—The amount that may be deducted under this heading is limited to a reasonable allowance for the exhaustion, and wear and tear of property, arising out of its use or employment in business or trade. This deduction is permitted even though the property has not actually been used, as when a plant remains idle, because of adverse business or other conditions. In such a case the amount of depreciation allowed will usually be less than if it had been in operation. The fact that the property may have been acquired by gift does not prevent a reasonable allowance for depreciation from being deducted, providing, of course, that the property is used for business purposes.

But no depreciation is allowed on a building occupied as a residence by the owner. If the building is also partly rented to one or more tenants, a proportionate part of the depreciation may be deducted.[1]

Where in the course of years, the owner of property has claimed its full cost as depreciation in his income tax returns, no further claim for depreciation will be allowable. Repairs, however, will nevertheless be allowable.

The methods of determining the amount of depreciation that may be deducted each year are fully discussed in the Chapter on Corporate Income Tax, Depreciation.

Depreciation on personal items.—Depreciation is not allowable on items used for personal pleasure or convenience, such as pleasure automobiles, etc. Depreciation is allowed only when the property itself is used for the purpose of producing income. It will also be allowed when property is vacant and the owner intends to use it for business purposes.

If the article is used for both business and pleasure, depreciation may be deducted in proportion to the amount of business use the article received.

Depreciation in land values.—Depreciation in the value of land is not allowable as a deduction, nor must appreciation in the value of the land be reported as income, until the land is sold. And this is true even when depreciation is deducted on the building standing on the land.

Depletion.—The question of depletion of oil wells, mines, etc., is discussed under "Corporate Income Tax," which see also for a complete discussion of other forms of depletion. See p. 233.

No deductions allowed for improvements, etc.—No deduction is allowed for payments for new buildings, permanent improvements, or for betterments made to increase the value of the property. The distinction be-

[1] See page 104.

tween an improvement and a repair is very often a fine one.[1] The distinction is brought out in the following three citations:

(1) The most commonly accepted is that in so far as the transaction results in an addition of substantial and permanent character which increases the value of the plant, such increase is a capital expense and should be charged to the construction account. (*Mackintosh vs. Flint & Pere Marquette Ry.* 34. Fed. Rep. 60). Or, as it is clearly expressed in *Hubbard vs. Weare:* "Money paid out should not be reckoned as an asset. If paid for property that is on hand, the property is an asset. If expended in a way that has enhanced the value of the general assets it is included in its valuation. If so expended as to have brought no property, and no enhancement of that on hand, then it is a loss, and should not be counted as an asset." (79 Ia. 678.)

(2) A more extreme view is that expressed, for instance, by T. F. Woodlock: "An addition which does not increase revenue or diminish expenditure is not a proper capital charge according to the best modern practice in railroads. That which simply tends to *hold* business and not to *increase* business is a proper charge against *operating expenses.*"[2]

(3) At the other extreme is the view, presented in the decision by Lord Kyllachy in *Cox vs. Edinburgh and District Tramways Company, Lim.* (6 S. L. T. 63) (1898) that where an improvement is made in the plant, even though it be in the nature of the substitution of a new plant for old, the entire cost of the new plant, and not merely the excess in value of the new over the old, may be charged to construction account.

Of these three views the first is not only the most generally accepted but seems to comport best with

[1] See also Chapter on Corporation Deductions for further treatment of repairs and renewals and depreciation, pp. 221-233.

[2] *Engineering Magazine,* Vol. xi, p. 241.

accounting principles. It has furthermore been authoritatively adopted for railway accounting by the Interstate Commerce Commission. The second view, while praised for its conservatism seems to imply that there must be a constant rate of normal interest or profits, a condition denied by economic history. If a general decline in profits occurs, an improvement which, in a given enterprise, prevents the fall and maintains the old rate of profits is clearly a source of additional value, and would be capitalized in the money market. The third view is rarely justified by accountants.[1]

[1] Hatfield, *Modern Accounting.*

CHAPTER V

INDIVIDUAL INCOME TAX

RATE OF TAX

On whom imposed.—Citizens and residents of the United States, including the territories of Alaska and Hawaii and the District of Columbia, are subject to two distinct taxes on their income for the calendar year of 1917.

The original Income Tax law, as amended September 8, 1916, remains in force, subject to some modifications caused by the act of October 3, 1917. This act, under Title I, imposed an *additional* tax on the net income of every individual, a citizen or resident of the United States.

Non-resident aliens are not subject to the normal tax imposed by the 1917 law, but they are subject to the super-taxes imposed by that law. They are not allowed to deduct the specific exemption allowed under the 1916 law.

Citizens of the Philippines and Porto Rico are considered citizens of the United States under the 1916 law, but they are specifically exempt from the provisions of the 1917 law.

The liability of the different classes of individuals to the various taxes is clearly shown by the following table:

Class	Normal tax 1916	Normal tax 1917	Super-tax 1916	Super-tax 1917
Citizens and residents of the United States	Yes	Yes	Yes	Yes
Non-resident alien individuals	Yes [1]	No	Yes	Yes
Residents of Porto Rico and the Philippines	Yes	No	Yes	No

[1] Non-resident aliens are not now allowed the specific exemption of $3,000 or $4,000.

Rates under 1916 law.—The 1916 law levies a *normal* or *base* tax at the rate of 2 per cent on the net income of every citizen or resident of the United States and every non-resident alien, and in addition levies surtaxes as follows:

On net income in excess of	$20,000 and not over $40,000........	1%
On net income in excess of	40,000 and not over 60,000........	2
On net income in excess of	60,000 and not over 80,000........	3
On net income in excess of	80,000 and not over 100,000........	4
On net income in excess of	100,000 and not over 150,000........	5
On net income in excess of	150,000 and not over 200,000........	6
On net income in excess of	200,000 and not over 250,000........	7
On net income in excess of	250,000 and not over 300,000........	8
On net income in excess of	300,000 and not over 500,000........	9
On net income in excess of	500,000 and not over 1,000,000........	10
On net income in excess of	1,000,000 and not over 1,500,000........	11
On net income in excess of	1,500,000 and not over 2,000,000........	12
On net income in excess of	2,000,000	13

Deductions from net income allowed for normal tax under 1916 law.—1. *Specific exemptions of* $3,000 *or* $4,000. For the purpose of the normal tax only, every individual (except non-resident aliens) is allowed to deduct from his income the sum of $3,000 as an exemption. Thus, if a man's income is $5,000, he may deduct $3,000, and the 2 per cent tax will be imposed on only $2,000.

If the person making the return is the head of a family, or a married man with a wife living with him, or a married woman with a husband living with her, he or she is allowed an exemption of $4,000. For definition of head of family see next section.

If the husband and wife are living together, only one deduction of $4,000 may be made from their aggregate income.

The income of husband and wife need be combined only for the normal tax.[1] Surtaxes will be levied on the separate incomes.

[1] The parent is held to be the natural guardian of the minor child. Income received by a minor child from sources other than the parent should be included by the parent in his return of income. The fact that such

If husband and wife are living apart, each is entitled to an exemption of $3,000.

If the person making the return is married or is the head of a family, he is allowed, in addition to the exemption of $4,000, $200 for each dependent child who is under 18 years of age or else incapable of self-support because of mental or physical defect. This $200 additional exemption is not allowed for other dependents.

The single or married status of a person claiming the specific exemption is determined as of the close of the year for which the return is made.

Guardians or trustees are allowed to make this personal exemption of $3,000 or $4,000 from the income derived from the property of which they have charge, in favor of each ward or cestui que trust (beneficiary).

An exemption of $3,000 is allowed from the net income of a decedent's estate during its administration or settlement, even though the period be less than one year, and from a trust or other estate the income of which is not distributed annually or regularly.

Where a person dies during the year, his executor, in filing the return of decedent's income, may claim the full specific exemption of $3,000 or $4,000, as the case may be, according to the marital status of such person at the time of his death.

2. *Dividends.*—To arrive at the net income on which the normal tax will be applied, dividends received from domestic corporations should also be deducted. The

income is not appropriated by the parent is immaterial, as it will be held, in the absence of a showing of fact to the contrary, that such income was subject to appropriation by the parent and that the child receives the same as a gift from the parent.

When the income is from a separate estate and the parent has been appointed guardian and the facts are such that the income so received is to be held for the use of the child, it should not be included in the return of income for the parent, but should be accounted for otherwise for the purpose of the Income Tax in the manner and form called for by the facts of the particular case. See Chapter on Fiduciaries, p. 288.

amount deducted should include only dividends from domestic corporations, joint-stock companies, Massachusetts trusts, associations and insurance companies, dividends from foreign corporations whose entire net income is from sources within the United States, and also profits from limited partnerships. The income of all these organizations is subject to the Corporation Income Tax when earned. To tax their income again when distributed would be a form of double taxation. Dividends and profits from organizations which are subject to the income tax are exempt from the normal tax of both laws. They are, however, subject to the surtaxes imposed by both laws, provided they were paid out of 1917 surplus or undivided profits. If the dividends were paid out of surplus or undivided profits accumulated in 1916 [1] they are, by the provisions of the law (sec. 31), subject to the super-taxes at the rates in effect for the year 1916. This means that they are *not* subject to the super-tax imposed by the 1917 law. Dividends paid from surplus acquired in the years 1913 to 1915 inclusive are subject to the super-taxes in effect for that period.[2] The super-taxes for the period from 1913 to 1915 are the same as those for 1916 until the net income exceeds $40,000. Above that amount, the rates in the 1916 law are a trifle higher. Individuals with an income in excess of $40,000 who have received dividends paid out of surplus earned in the years 1913, 1914 and 1915 are entitled to take credit on the returns for the amount by which the surtax on

[1] In the case of profits distributed out of the most recent earnings of a corporation which closes its books as of June 30, 1917, so much of the dividend as represented the distribution of earnings for the period January 1 to January 30, 1917, inclusive, would be subject, in the hands of the stockholders receiving same, to the graduated additional taxes imposed by the act of September 8, 1916, as amended, and the act of October 3, 1917, and so much of it as represented a distribution of profit or surplus accumulated in 1916 would be subject to additional tax at the 1916 rate.

[2] For the method of determining out of which year's surplus the dividend was paid, see pp. 78-88.

such dividends as figured under the 1916 law exceeds the amount as figured under the 1913 law. (See Computation of Tax, next chapter.)

3. *Interest on bonds* of the second Liberty Loan, i.e., first and second 4s. Interest on bonds of the first Liberty Loan is entirely exempt from the tax and should not appear in the return.

Head of family.—For the purpose of the personal exemption, the head of a family is held to be any person who actually supports and maintains one or more individuals who are closely connected with him by blood relationship, relationship by marriage or adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligations. For example, the oldest son of a family supporting a widowed mother and several minor children would come within this class. In some cases there may be two members of a family, each of whom is the "head of a family." For example, *A* and *B* are brothers supporting a mother and a grandmother. *A* and *B* may each claim to be the head of a family, as each is supporting one dependent. Each may therefore claim an exemption of $4,000.

Deductions from net income allowed for super-tax computation.—1. Interest received on bonds of the second Liberty Loan is deductible from the net income for the purpose of the super-tax only to the extent that such interest is from a principal of $5,000 or less. The maximum deduction in any one year would therefore be $200.[1]

2. Interest paid on obligations incurred in the purchase of bonds of the second Liberty Loan, either first or second 4s, is deductible for the purpose of the super-tax.[2] Interest paid on obligations incurred in the pur-

[1] For the year 1917 the maximum deduction will be $25. The bonds bear interest from November 15, 1917. A person selling them December 31, 1917, would get 1½ month's interest.

[2] The amount of interest deductible is that proportion of total interest payments which the excess over $5,000 is to the total amount of such bonds purchased. See Chapter on Returns, Form 1040, Division E, p. 149.

chase of bonds of the first Liberty Loan, i.e., the 3½s, is not deductible. But if, while the obligation was still in force, the 3½ per cent bonds were converted into the 4 per cent bonds, the interest on the loan from the date of conversion may be deducted.

Rates under 1917 law.—The law of October 3, 1917, levies an additional normal tax of 2 per cent on the net income of every individual, a citizen or resident of the United States. Non-resident aliens, and citizens of Porto Rico and the Philippines are not subject to the normal taxes imposed by this law.

The 1917 law imposes additional surtaxes on all individuals, including non-resident aliens, and excluding citizens of Porto Rico and the Philippines, as follows:

On net income in excess of	and not over	Supertax imposed by 1917 act[1]	Total surtax including 1916 and 1917 rates[1]
$5,000	$7,500	1%	1%
7,500	10,000	2	2
10,000	12,500	3	3
12,500	15,000	4	4
15,000	20,000	5	5
20,000	40,000	7	8
40,000	60,000	10	12
60,000	80,000	14	17
80,000	100,000	18	22
100,000	150,000	22	27
150,000	200,000	25	31
200,000	250,000	30	37
250,000	300,000	34	42
300,000	500,000	37	46
500,000	750,000	40	50
750,000	1,000,000	45	55
1,000,000	1,500,000	50	61
1,500,000	2,000,000	50	62
2,000,000		50	63

Deductions from net income allowed for 1917 normal tax.—The deductions for the normal tax allowed under the

[1] The Excess Profits tax rates are not included in this table.

1916 law are allowed under the 1917 law, with the exceptions that:

1. The personal exemption is reduced to $1,000 for individuals other than married persons or heads of families.

2. The personal exemption for married individuals or heads of families is reduced to $2,000 plus an extra allowance of $200 for each dependent child.

3. Personal exemption on income of decedent prior to his death is reduced to $1,000 or $2,000, according to his marital status at the time of his death.

4. Deduction allowed to estates pending settlement and on undistributed income of trust estates is reduced to $1,000.

Another difference between the 1916 and 1917 laws, as far as deductions are concerned, is that the latter permits the deduction of such part of the income from partnerships distributable during the year as is taxable, according to the provisions of section 8, paragraph (e) of the law, at the rates in effect for the year 1916. This section provides that a partnership may establish a fiscal year and that the income of the partnership in that case shall be prorated, as between 1916 and 1917, on the basis of the number of months of their fiscal year falling within the calendar year. To illustrate: The partnership of *A* and *B* for the fiscal year ending June 30, 1917, earned $100,000, of which *A* was entitled to $60,000 and *B* to $40,000. Of this $100,000, six-twelfths (the number of months falling in 1917), or $50,000, is taxable at the rates in effect for the year 1917, that is, the rates in effect for the year 1916 plus the 1917 rates; the balance of $50,000 is taxable only at the 1916 rates. *A* will report his $60,000 as income from partnership, and in calculating his tax will deduct one-half or $30,000, from his net income, and pay the taxes in effect for the year 1917 only on the remaining $30,000. This $30,000 deducted is subject to tax only at the 1916 rates.

RATES OF TAX BASED ON A PERSONAL EXEMPTION OF $4,000 AND $2,000 UNDER THE 1916 AND 1917 LAWS RESPECTIVELY*

Income	Normal, 1916	Normal, 1917	Total Normal	Supertax, 1916	Supertax, 1917	Total Supertax	Total Tax
$1,000 to $2,000....	...	...	....	....	....	....	....
2,000 to 3,000....	...	2%	2%	....	....	....	2%
3,000 to 4,000....	...	2	4	....	....	....	4
4,000 to 5,000....	2%	2	4	....	....	....	4
5,000 to 7,500....	2	2	4	....	1%	1%	5
7,500 to 10,000....	2	2	4	....	2	2	6
10,000 to 12,500....	2	2	4	....	3	3	7
12,500 to 15,000....	2	2	4	....	4	4	8
15,000 to 20,000....	2	2	4	....	5	5	9
20,000 to 40,000....	2	2	4	1%	7	8	12
40,000 to 60,000....	2	2	4	2	10	12	16
60,000 to 80,000....	2	2	4	3	14	17	21
80,000 to 100,000....	2	2	4	4	18	22	26
100,000 to 150,000....	2	2	4	5	22	27	31
150,000 to 200,000....	2	2	4	6	25	31	35
200,000 to 250,000....	2	2	4	7	30	37	41
250,000 to 300,000....	2	2	4	8	34	42	46
300,000 to 500,000....	2	2	4	9	37	46	50
500,000 to 750,000....	2	2	4	10	40	50	54
750,000 to 1,000,000....	2	2	4	10	45	55	59
1,000,000 to 1,500,000....	2	2	4	11	50	61	65
1,500,000 to 2,000,000....	2	2	4	12	50	62	66
2,000,000 and over.......	2	2	4	13	50	63	67

* The rates of tax for individuals who are unmarried and have no dependents are exactly the same as shown above, except that the 1916 *normal* tax begins at $3,000, and the 1917 *normal* tax begins at $1,000. The total tax rates on such persons are as follows: $1,000 to $3,000, 2%; $3,000 to $5,000, 4%; $5,000 to $7,500 and above this, the rates are the same as shown in the last column in the table.

INCOME

BASED ON A PERSONAL EXEMPTION OF $4,000 AND

Taxable Income	(1) 1916 Normal Tax	(2) 1916 Supertax	(3) 1916 Total Tax	(4) 1917 Normal Tax	(5) 1917 Supertax
$1,000	....	....	....	....	....
2,000	....	....	....	....	....
3,000	....	....	....	20	....
4,000	....	....	....	40	....
5,000	20	....	20	60	....
6,000	40	....	40	80	10
7,000	60	....	60	100	20
8,000	80	....	80	120	35
9,000	100	....	100	140	55
10,000	120	....	120	160	75
12,500	170	....	170	210	150
15,000	220	....	220	260	250
20,000	320	....	320	360	500
25,000	420	50	470	460	850
30,000	520	100	620	560	1,200
40,000	720	200	920	760	1,900
50,000	920	400	1,320	960	2,900
60,000	1,120	600	1,720	1,160	3,900
75,000	1,420	1,050	2,470	1,460	6,000
80,000	1,520	1,200	2,720	1,560	6,700
100,000	1,920	2,000	3,920	1,960	10,300
125,000	2,420	3,350	5,670	2,460	15,800
150,000	2,920	4,500	7,420	2,960	21,300
200,000	3,920	7,500	11,420	3,960	33,800
250,000	4,920	11,000	15,920	4,960	48,800
300,000	5,920	15,000	20,920	5,960	65,800
400,000	7,920	24,000	31,920	7,960	102,800
500,000	9,920	33,000	42,920	9,960	139,800
600,000	11,920	43,000	54,920	11,960	179,800
750,000	14,920	58,000	72,920	14,960	239,800
1,000,000	19,920	83,000	102,920	19,960	352,300
1,500,000	29,920	138,000	167,920	29,960	602,300
2,000,000	39,920	198,000	237,920	39,960	852,300

Column 1 is the amount of the normal tax imposed by the law of Sept. 8, 1916. Allowance is made for a personal exemption of $4,000.

Column 2 is the amount of the supertax imposed by the law of Sept. 8, 1916.

Column 3 is the amount of total tax, both normal and supertax, imposed by the Law of Sept. 8, 1916. Allowance is made for a personal exemption of $4,000.

Column 4 is the amount of normal tax imposed by the law of Oct. 3, 1917. Allowance is made for a personal exemption of $2,000.

Column 5 is the amount of supertax imposed by the law of Oct. 3, 1917.

Column 6 is the amount of the total tax imposed by the law of Oct. 3, 1917. Allowance is made for a personal exemption of $2,000.

Column 7 is the total tax imposed by both laws and is the amount of tax that will be paid by citizens and residents of the United States who are mar-

TAX CHART

$2,000 UNDER THE 1916 AND 1917 LAWS RESPECTIVELY

(6) 1917 Total Tax	(7) Total Tax for 1917	(8) 1916 Tax Actual % of Income	(9) 1917 Tax Actual % of Income	(10) Total Tax Actual % of Income	Taxable Income
....	....	.....	.....	.....	$1,000
....	....	.....	.....	.....	2,000
20	20	.....	.67	.67	3,000
40	40	.....	1.00	1.00	4,000
60	80	.40	1.20	1.60	5,000
90	130	.67	1.50	2.17	6,000
120	180	.86	1.71	2.57	7,000
155	235	1.00	1.94	2.94	8,000
195	295	1.11	2.16	3.27	9,000
235	355	1.20	2.35	3.55	10,000
360	530	1.36	2.88	4.24	12,500
510	730	1.47	3.40	4.87	15,000
860	1,180	1.60	4.30	5.90	20,000
1,310	1,780	1.88	5.24	7.12	25,000
1,760	2,380	2.07	5.87	7.94	30,000
2,660	3,580	2.30	6.65	8.95	40,000
3,860	5,180	2.64	7.72	10.36	50,000
5,060	6,780	2.87	8.43	11.30	60,000
7,460	9,930	3.29	9.95	13.24	75,000
8,260	10,980	3.40	10.32	13.72	80,000
12,260	16,180	3.92	12.26	16.18	100,000
18,260	23,930	4.54	14.61	19.15	125,000
24,260	31,680	4.95	16.17	21.12	150,000
37,760	49,180	5.71	18.88	24.59	200,000
53,760	69,680	6.37	21.50	27.87	250,000
71,760	92,680	6.97	23.92	30.89	300,000
110,760	142,680	7.98	27.69	35.67	400,000
149,760	192,680	8.58	29.95	38.53	500,000
191,760	246,680	9.15	31.96	41.11	600,000
254,760	327,680	9.72	33.97	43.69	750,000
372,260	475,180	10.29	37.23	47.52	1,000,000
632,260	800,180	11.19	42.15	52.34	1,500,000
892,260	1,130,180	11.90	44.61	56.51	2,000,000

ried or have dependents, for the calendar year 1917. The taxpayer may subtract from these taxes, $4 for each dependent under 18 years of age, or incapable of self-support due to mental or physical disability, if the tax is $40 or less. If the tax is above $40, he may subtract an additional $4 for each such dependent from the amount of the tax above $40.

Column 8 is the actual per cent of income taken by the tax under the 1916 law.

Column 9 is the actual per cent of income taken by the tax under the 1917 law.

Column 10 is the actual per cent of income taken by the total tax for the year 1917.

EFFECT OF TOTAL TAX ON

Taxable Income	3½'s	4's	4½'s	5's
$2,000	3.50	4.00	4.50	5.00
3,000	3.477	3.973	4.470	4.966
4,000	3.465	3.960	4.455	4.95
5,000	3.444	3.936	4.428	4.92
6,000	3.424	3.913	4.402	4.891
7,000	3.410	3.897	4.384	4.871
8,000	3.397	3.882	4.368	4.853
9,000	3.386	3.869	4.353	4.836
10,000	3.376	3.858	4.341	4.823
12,500	3.352	3.831	4.310	4.788
15,000	3.33	3.806	4.282	4.757
20,000	3.294	3.764	4.234	4.705
25,000	3.251	3.715	4.179	4.644
30,000	3.222	3.683	4.143	4.603
40,000	3.177	3.642	4.097	4.552
50,000	3.137	3.586	4.034	4.482
60,000	3.105	3.548	3.992	4.435
75,000	3.026	3.470	3.904	4.338
80,000	3.019	3.451	3.882	4.314
100,000	2.933	3.353	3.772	4.191
125,000	2.830	3.235	3.639	4.043
150,000	2.761	3.155	3.550	3.944
200,000	2.639	3.016	3.393	3.770
250,000	2.525	2.885	3.246	3.606
300,000	2.419	2.765	3.111	3.457
400,000	2.252	2.572	2.895	3.216
500,000	2.151	2.458	2.766	3.073
600,000	2.061	2.356	2.650	2.944
750,000	1.971	2.253	2.534	2.816
1,000,000	1.837	2.099	2.362	2.624
1,500,000	1.833	1.866	2.099	2.333
2,000,000	1.523	1.739	1.957	2.175

YIELD OF TAXABLE BONDS

5½'s	6's	6½'s	7's	Yield of Liberty 4's %	Taxable Income
5.50	6.00	6.50	7.00	4.00	$2,000
5.463	5.959	6.457	6.953	4.00	3,000
5.445	5.940	6.435	6.93	4.00	4,000
5.412	5.904	6.396	6.888	4.00	5,000
5.380	5.869	6.359	6.848	3.993	6,000
5.359	5.846	6.333	6.820	3.988	7,000
5.338	5.824	6.309	6.794	3.982	8,000
5.320	5.804	6.287	6.771	3.975	9,000
5.305	5.787	6.269	6.752	3.97	10,000
5.267	5.746	6.224	6.703	3.952	12,500
5.233	5.708	6.184	6.659	3.933	15,000
5.175	5.646	6.116	6.587	3.9	20,000
5.108	5.573	6.037	6.502	3.856	25,000
5.064	5.524	5.984	6.445	3.827	30,000
5.008	5.463	5.918	6.374	3.79	40,000
4.931	5.397	5.827	6.275	3.736	50,000
4.872	5.322	5.766	6.208	3.7	60,000
4.77[illegible]	5.206	5.639	6.073	3.624	75,000
4.745	5.177	5.608	6.039	3.605	80,000
4.610	5.029	5.449	5.867	3.508	100,000
4.447	4.852	5.256	5.660	3.39	125,000
4.338	4.733	5.127	5.522	3.31	150,000
4.146	4.524	4.902	5.278	3.174	200,000
3.967	4.328	4.688	5.049	3.043	250,000
3.803	4.148	4.494	4.840	2.922	300,000
3.538	3.860	4.181	4.503	2.732	400,000
3.381	3.688	3.995	4.303	2.617	500,000
3.237	3.532	3.826	4.120	2.515	600,000
3.098	3.379	3.661	3.942	2.412	750,000
2.886	3.149	3.411	3.674	2.259	1,000,000
2.566	2.799	3.032	3.2[illegible]5	2.026	1,500,000
2.392	2.609	2.827	3.044	1.9	2,000,000

CHAPTER VI

INDIVIDUAL INCOME TAX

RETURNS AND COMPUTATION OF TAX

RETURNS

Filing of returns.—Every individual required by law to file a return must file a return of his or her net income for the calendar year on or before March 1 of the following year. The time for filing the return for 1917, however, has been extended to April 1, 1918.

The return must be made out and sworn to in person by the individual from whom the return is due, unless he is unable to do so by reason of minority, sickness, absence, or insanity. In such cases the return should be made by the individual's guardian or agent.

As is explained in a later chapter on "Fiduciaries," fiduciaries need report only the income of the persons, trusts, or estates for whom they act as fiduciaries, unless they are legally authorized to act for the beneficiaries as agents or attorneys. In fact, a fiduciary is under no obligation to make out the personal return for the beneficiary unless the beneficiary is a non-resident alien or incompetent. The liability of the fiduciary to make a return applies only with respect to such income as accrues and is payable through himself, and not to the income of the beneficiary derived from other sources.

Extensions of time for filing returns.—The collector of the district may, in cases of sickness or absence, grant an extension of time, not exceeding 30 days from the time the return would otherwise be due.

The Commissioner of Internal Revenue has authority to grant a further extension of time for any adequate reason. Under this provision of the law an extension of time has been granted for the filing of returns for the year 1916 and subsequent years to non-resident alien individuals and corporations and to American citizens residing abroad. These individuals will be given, by the provisions of T. D. 2581, until 90 days after the proclamation of the President of the United States announcing the end of the war with Germany. This extension applies only in those cases where the delay was caused by war conditions. In all such cases there must be attached to the return, when made, an affidavit stating the cause or causes of delay in filing returns of income within the time required by law. If this affidavit shows that the failure to file the return in time was excusable, no penalty will be incurred.

In cases where a complete return cannot be filed within the time prescribed by law or within the extension period, a tentative return should be filed within the time in order to avoid any penalty which would otherwise be incurred (see page 22). Following this tentative return, a true and accurate return should be filed just as soon as the data to be incorporated in the complete return are available.

Where return is to be filed.—The return should be filed with the collector of internal revenue for the district[1] in which the individual has his legal residence or place of business. If the individual has no legal residence or place of business in the United States the return must be filed with the collector of internal revenue at Baltimore, Md. A fiduciary should file a return with the collector of internal revenue for the district in which he resides.

The location of an individual's legal residence may be subject to dispute. As far as the income tax is con-

[1] See Collection Districts, p. 609.

cerned, it makes no difference in what district the return is filed, except that for administrative purposes the Department prefers that it be filed in the district in which the individual resides.

The filing of a return in a certain district would be an admission on the part of the individual that his legal residence was within that district, which admission might be important as far as State inheritance and personal property taxes are concerned.

Form of return.—The return must be made out on the form furnished by the collector of internal revenue, and must be signed and sworn to before an officer authorized by law to administer oaths.

The forms of returns provided for the use of individuals are Form 1040 A, to be used by individuals having a net income not in excess of $3,000, and Form 1040, to be used by individuals having a net income in excess of $3,000. The information required on each of the forms is discussed in the preceding chapters; the preparation and execution of the form is discussed on the following pages.

FORM 1040 A

When Form 1040 A is to be used.—This form is designed to be used by individuals whose income is subject only to the 2 per cent tax imposed by the War Revenue Act of October 3, 1917.

The maximum amount of income for which this form may be used in various cases is as follows:

	Income not exceeding
Single—not head of family	$3,000
Married or head of family	4,000
Married or head of family, which includes one dependent child	4,200
two dependent children	4,400
three dependent children	4,600
four dependent children	4,800
five or more dependent children	5,000

In order to determine whether or not a return should be filed, or whether or not this form may be used, the amount of net income should be calculated on page 3 and totaled on line H of the Form. This amount is then forwarded to page 4 and to it is added (a) the amount of dividends received and (b) the amount of interest on tax-free covenant bonds.[1]

Interest on bonds of the second Liberty Loan, War Savings certificates and Treasury certificates of indebtedness, are subject to the super-tax on the interest from bonds and certificates in excess of a total of $5,000 par value. The amount of such interest on the amount of bonds and certificates held by one individual in excess of $5,000 should also be added in arriving at this total income. The officials in making up this form have apparently overlooked the possibility that a person with such an income, as shown on line 13, of less than $5,000 may be the owner of more than $5,000 worth of bonds of the second Liberty Loan and certificates mentioned above.

From the resulting figure of total income there should be deducted the amount of contributions.[2] The amount deducted is limited to 15 per cent of the total income shown on the line above. The resulting figure is the total net income. If this figure is in excess of the amount stated as a maximum on the preceding page, the large form, 1040, should be used.

No individual whose net income for the calendar year has been less than $1,000 need file a return,[3] and no return is required of man or wife, or both, living together, if their combined net income is less than $2,000, including income of minor children.

Any other citizen or resident will not be required to file a return if his total net income is less than $1,000.

[1] See Chapter on Withholding, etc., at the Source, p. 266.

[2] See page 113.

[3] This refers to a return of taxable income, and not to the report of information at the source. See "Information at the Source," pp. 277-280.

The preparation of Form 1040 A.—Page 3 of the form should be filled out first. This form does not have the separation of total income and total deductions provided in the old forms. Instead, income is divided into five subdivisions, and certain deductions are allowed directly against a certain class of income. In addition, a section is provided for general deductions, not applicable to any specific class of income.

Section A includes income from salaries, wages, commissions, bonuses and pensions. These items are discussed on pp. 48 to 52.

Division B includes income from business, farm, or profession.

This section requires the gross receipts from the sale of farm products, merchandise, or business or professional services to be reported. (See pp. 52-59.) The deductions against these receipts are:

1. Labor. Salary paid by the person making the return to himself or members of his dependent family should not be deducted here unless it is included as income in Section A. But the salary paid a member of the family (other than wife) *may be* deducted here and not be included as income elsewhere in the return, if such person is 21 years of age or over and not actually a dependent. In such case that person should file a personal return of net income in excess of $1,000 or $2,000, as the case may be.

2. Materials and supplies. The instruction as to inventories is, that increases in inventories should be added to the gross receipts, and decreases in inventories should be added to the amount of expenses. On pages 52-56 it is pointed out that the proper method is to deduct the inventory increase or add the inventory decrease to the purchases of materials. The result in either case is the same.

3. Rent. The deduction of rent in cases where a building is used both for business and as a dwelling

and other questions arising under "Rent" are discussed on page 104.

4. Merchandise or live stock bought for sale. The comment as to inventories of materials and supplies applies to merchandise also. The instructions do not state whether inventories should be valued at cost or market value. This question is still open, and a discussion of it will be found on pages 54 and 55.

5. Wear and tear and repairs. This includes not only the amount paid out for repairs but also an allowance for depreciation. For a full discussion, see pp. 122-124.

6. Losses by fire, storm, other casualties, or theft. Losses from bad debts should apparently be included under "Other expenses."

7. Other expenses. In the instructions this is called: "Other expenses and losses." Losses from bad debts should be included under this heading. Losses on bad debts arising from transactions not connected with the individual's business should be deducted under Division G, as a general deduction.

Items 1 to 7 should be totaled and deducted from the amount of gross receipts reported. This will give the net income from business, farm or profession.

In order to support the item of wear, tear and repairs, a statement is required of the cost of the business or farm property; of the construction of the buildings; and the cost of the business equipment.

Division C. Profit from sale of land, buildings, and other property, real or personal. As to each item of property sold, there is required a statement of

1. The kind of property, that is, "farm," "apartment house," "dwelling," "mine," etc.

2. The year in which the property was acquired.

3. The sale price of the property.

4. The cost of the property, or the fair market value, as of March 1, 1913, if it was acquired prior to

March 1, 1913. Depreciation or depletion previously deducted from income must be deducted from the cost. Other factors affecting the profit are discussed in the chapter on Individual Income, pp. 59-66.

Division D. Income from rents and royalties (pp. 66-67 and 76-77).—The form requires as to each piece of property a statement of:

1. The kind of property, including its construction.
2. The cost of the building. This should be only the cost of the property on which an allowance for depreciation is claimed.
3. The cash or equivalent received as rent or royalty.
4. The amount of wear, tear and repairs. In the case of oil and gas wells, mines, etc., a reasonable allowance may be deducted for depletion. See chapter on Corporation Income, Deductions.
5. Other expenses and losses.

The amount received as rent or royalty (3), less the sum of the wear, tear and repairs (4), and expenses (5), will be the net income from rents and royalties.

Division E. Other income.—All income not reported under the previous headings must be reported here with the exception of:

1. Dividends received from corporations which are themselves subject to the income tax. (See p. 78.)
2. Interest received on bonds on which the issuing corporation has agreed to pay the tax. (See chapter on Withholding, Deduction and Information at the Source.)
3. Interest received on bonds of the United States or its possessions, or any State or any political subdivision of a State. (See pp. 41 and 42.)
4. Interest on federal farm loans. (See p. 39.)
5. Proceeds of life insurance policies paid by the insured and premiums returned by life insurance companies. (See p. 40.)
6. Principal only of gifts and legacies. (See p. 41.)

The first two items would be subject to the super-tax if the income were in excess of $5,000, and therefore must be shown on page 4 of the return to make sure that the net income would not exceed $5,000 if these were included.

The income from partnership, excluding any income from items 1, 3, 4, 5, 6 listed above, should also be included. (See pp. 56 and 71 to 75.) Interest on tax-free covenant bonds received through a partnership must be included as income. No withholding is authorized against partnerships and therefore the issuing corporation cannot pay the tax at the source, in accordance with its contract. (See chapter on "Withholding, Deduction, and Information at the Source.")

The instructions do not mention the fact that where a partnership determines its profits on the basis of a fiscal year the individual partners are taxed on their shares of the profits at the rates in effect for the respective years in which such profits were earned. Individuals who received income from a partnership closing its books as of a fiscal year should apportion such income between 1916 and 1917, as explained in the chapter on Income from Partnerships (pp. 72 to 73). The entire amount should be reported under Column 1 as "Cash received"; the amount determined as earned in 1916 under Column 2 as expenses paid, and the difference will be the amount taxable as income for 1917.

Income on which the tax has not been paid, received from fiduciaries, excluding any income from items 1 to 6 listed on the preceding page should also be reported. (See Chapter on Fiduciaries.)

The net income as shown under headings A to E inclusive should be totaled, giving the total net income. If a loss is reported under Division B, D, or E it may be shown as a general deduction under Division G. If a loss is shown under Division C, it will be allowed as a deduction only if the transactions out of which the

loss resulted were connected with the individual's business. (See p. 113, Deductions.) If this deduction is claimed a statement must be attached to the return explaining how the transactions were connected with the individual business.

Division G. General deductions.—Under "Interest paid," all interest payments should be deducted, except interest paid on obligations incurred in the purchase of tax-exempt securities, including Liberty Bonds of the first and second loan.

Taxes (see p. 110), losses on personal loans and on other bad debts that are not connected with the individual's business (see p. 120) may also be deducted. Charitable contributions made should not be included in this section.

F.—The net income will be the difference between the total net income and the general deductions. From this figure may be deducted contributions made to religious, charitable and educational organizations to an amount not in excess of 15 per cent of the total net income (including dividends and interest from tax-free bonds), as previously explained. (See p. 113, Deductions.)

From this "balance of net income," as it is called on the form, is to be deducted the personal exemption allowed by the law, which is explained in the preceding chapter on Rate of Tax. The resulting figure is the income subject to the 2 per cent tax imposed by the act of October 3, 1917. The tax due will be 2 per cent of this figure.

Additional information required.—In addition to the statement of his net income, the taxpayer must also state whether or not he filed a return for 1916, and if so, what address he gave and to what collector's office he sent the return. He must also support his claim for personal exemption by stating his status as of December 31, 1917. He must also state whether or not a

separate return was made by his wife, or dependent child, and if so, the name under which such return was filed. He must also give any other address which he furnished to any person, firm or corporation from whom he received $800 or more income during 1917.

The return must be signed by the taxpayer or his agent and properly sworn to. If signed by an agent, the reason why the return is made by the agent must be given.

Special provision has been made for the verification of returns of individuals in the naval and military forces of the United States. The verification of the return by any officers authorized to administer oaths for military or naval justice will be accepted by the Treasury Department.

FORM 1040

The preparation of Form 1040.—Form 1040 is to be used by individuals having a net income in excess of $3,000, although as previously stated, Form 1040 A may, under certain conditions, be used by individuals having a net income in excess of $3,000, but not in excess of $5,000.

The taxpayer is required to report his net income under one or more of the headings shown in the return.

Net income is grouped into eight divisions, a short discussion of the items to be reported under heading follows:

Division A. Income from salaries, wages, commissions, bonuses, directors' fees, pensions and from professions (see pp. 48-52).—Income resulting from the employment of other than nominal capital should not be reported under this heading but should be shown under Division B. A definition of nominal capital will be found in the Chapter on Excess Profits Tax. The income reported under this heading is subject also to a tax of 8 per cent on the amount in excess of $6,000

under the War Excess Profits Tax. The amount of this tax (Excess Profits) will be credited against the net income before computing the income tax. The income to be reported should be that income as is explained under "Salaries, Wages, Commissions, etc." A discussion of the various items which constitute allowable deductions against this income will be found in the chapter on "Individual Income Tax Deductions—Necessary Expenses." The nature of the deductions should be described briefly in the space provided on the form.

Salary or commission or other income amounting to $800 or more received from one person, firm or corporation should be reported separately, together with the name of the person, firm or corporation paying same.

Division B. Income from business, including farming (see pp. 52-59).—The form provides a clear method of showing the net income from business. A profit and loss statement taken from the books of the individual may be attached to the return and the net income shown by the statement entered as net income from business.

Merchandise and securities may be inventoried either at cost or at cost or market, whichever is lower. A discussion of the advisability of inventorying merchandise at market price will be found on pages 54 and 55.

Division C. Profits from sale of real estate, bonds and other securities (see pp. 59-66).—In determining the cost of real estate sold such incidental expenses of purchasing the property as have not been deducted in previous returns may be added to the original cost, as may also the amount of taxes assessed against the property for local benefits. The amount of depreciation deducted from income on previous returns should be added to the sales price.

If such transactions show a net loss, the loss will not

be permitted as a deduction unless the transactions were connected with the individual's regular business. A discussion of the meaning of "regular business" will be found in the chapter on "Individual Income Tax—Deductions."

Division D. Income from rents and royalties.—The amount received as rents (see pp. 66-67) or royalties (see pp. 76-77) should be reported here. The allowable deductions include repairs, depreciation, interest, taxes, and other expenses. See Chapter on "Individual Income Tax—Deductions."

Division E. Interest on bonds and other obligations of the United States issued after September 1, 1917.—There should be reported only the interest received on the amount of bonds of the second Liberty Loan, War Savings Certificates and Treasury Certificates of Indebtedness held by one individual in excess of a total of $5,000 of par value. From this there may be deducted that portion of the interest paid on indebtedness incurred in the purchase of such bonds or certificates as the amount of such obligations held in excess of $5,000 is to the total amount held. To illustrate: *A* purchased $10,000 worth of Liberty 4's on November 15, 1917. In order to purchase them he borrowed $10,000 from his bank at 5 per cent. He sold his bonds December 31, 1917, at par and accrued interest and with the proceeds took up his loan at the bank. He would report as follows:

1. Amount of bonds	$10,000.00
2. Amount of interest received on amount in excess of $5,000	25.00
3. Indebtedness incurred for the purchase of bonds or certificates	10,000.00
4. Interest paid on proportionate part of indebtedness (total interest paid $62.50), one-half of $62.50	31.25
5. Excess of interest paid	6.25

This excess of interest paid should be included among other deductions in Division J of the form, which will exclude such excess from the super-tax.

This excess interest paid is not a proper deduction from the normal tax and therefore must be added to the amount of income, subject to the normal tax, as provided on line 24.

Where the amount of interest received exceeds the amount of interest paid the excess amount received is included as income, but inasmuch as the interest on these bonds is subject only to the super-tax, the excess amount received must be deducted on line 19 from the amount of income subject to the normal tax.

Division F. Dividends on stock of corporations organized or operating in the United States and subject to the income tax.—To be included in this division the dividends must be on stocks of corporations which are subject to the income tax on their *entire* net income. As hereinbefore explained, dividends on stocks of foreign corporations transacting part of their business in the United States and therefore subject to tax on part of their net income should be included under "Other Income."

Dividends, as previously explained (see pp. 82-88), are taxed at the rates in effect for the years in which the surplus out of which they are paid was accumulated. Dividends should therefore be separated according to the year accumulated. The amount accumulated prior to 1913 need not be shown. The amounts in the years 1913, 1915, 1916, 1917 should be shown separately on the form, but only the amount accumulated in 1917 is included in the income subject to the taxes in effect for 1917. The tax on the amount accumulated in the previous years must be made separately and the amount of tax entered on line 37. The method used in this calculation is illustrated in the paragraphs on Computation of Tax, p. 155.

Division G. Interest on tax-free covenant bonds on which one normal tax of 2 per cent was withheld at the source.—Interest on bonds containing a tax-free covenant and on which *no* exemption has been claimed should be reported here. If exemption has been claimed and no tax paid at the source the interest should be reported under "Other Income," Division H.

Division H. Other income. All forms of income, with the exception of tax-exempt income, which have not been included elsewhere, should be reported under this heading.

Income from partnerships should be included, except that part of the profits which was originally derived from the following sources, which should be excluded:

1. Interest on obligations of the United States issued since September 1, 1917. This should be shown in Division E to the extent provided under that heading.

2. Dividends on stocks. This should be entered in Division F.

3. Interest on tax-exempt securities. These need not be shown on the return at all.

Where the fiscal year of the partnership differs from the calendar year the income should be apportioned as between 1916 and 1917. That portion which is determined to be earned in 1917 should be extended in the net income column. The portion which is applied to 1916 should be entered in the deduction column. The calculation of the tax upon this amount at the rates in effect for 1916 is to be made separately and the amount of the tax is to be added to the total tax due. See p. 72.

Income from fiduciaries should be entered here, excepting income from the three sources above, and also excepting interest on tax-free covenant bonds on which no exemption has been claimed. This interest should be included in Division G.

Division I. Total net income from all sources.—The

total of divisions A to H inclusive will give the total net income from all sources. From this may be deducted the "general deductions."

Division J. General deductions.—Under this heading will be included interest on personal indebtedness, taxes paid on dwelling, the excess interest paid as reported under Division E, the loss, if any, reported under B, D or H, and the loss, if any, provided under Division C, if such transactions formed part of the individual's business.

Division K. Total net income.—This is the difference between I and J.

Division L provides for the deduction from K of the amount of excess profit taxes, if any, for 1917. The resulting figure is *M*.

Division N. Contributions to charitable organizations.—Provides for the deduction from *M* of contributions to an amount not in excess of 15 per cent of item *M* (see Individual Income Tax—Deductions). These contributions must be listed. The final figure M minus N is the net income (Item *O*) on which the income tax, normal tax and super-tax, is to be calculated.

In the instructions on Form 1040, Revised, contributions cannot be over 15 per cent of item M. Item M, it appears, includes all income received with the exception of dividends received in 1917 paid out of corporations' accumulated profits earned in 1913, 1914, 1915 and 1916. Inasmuch as the income which may be reported under these four years is not added to the total in computing the amount to be extended on line M of page 4, the statement with reference to the total deductions on page 4 of Form 1040, that the contributions cannot exceed 15 per cent of item M, seems erroneous. It appears that the intent of Congress was to allow 15 per cent of the total taxable income of an individual and which should also include the dividends received in 1917 from corporations' accumulated

profit earned in years prior to 1917. By following strictly the instructions on Form 1040, it appears that an individual will not be allowed full deductions of contributions which should be allowed them.

Before computing the normal tax there should be deducted, as provided for by lines 19, 20, and 21 and 22, those items which are exempt from the normal tax, as follows:

1. Excess of interest received over interest paid on obligations incurred to purchase obligations of the United States issued since September 1, 1917 (Item E),

2. Dividends (Item F) paid out of 1917 earnings, and

3. The personal exemption (explained in Chapter on "Rate of Tax").

To the remaining balance (line 23) there must be added any items which are subject to the normal tax but not to the super-tax. The only item in this class is:

1. Excess of interest paid on indebtedness incurred for purchase, over interest received, on obligations of United States issued since September 1, 1917 (line 24), as shown under Division E.

The resulting amount (line 25) is subject to the 2 per cent normal tax imposed by the act of October 3, 1917. Deducting $2,000 (line 26), which is the difference between the personal exemptions allowed by the 1916 and 1917 laws, we have the income subject to the 2 per cent tax imposed by the act of September 8, 1916 (line 27).

Calculation of super-tax.—The super-tax or surtax will be calculated on Item O, "Net income on which income tax is to be calculated," according to the table on page 154.

To compute the amount of surtax due on any amount of net income in excess of $5,000, first find in Column A the largest sum which is less than the amount of total net income reported on the return, Item O, then find in Column E the corresponding amount of total surtax.

Amount of Net Income	Amount Subject to Surtax at Rate shown in Column C	Rate	Amount of Surtax at Each Rate	Total Surtax on Each Amount
A	B	C	D	E
$5,000	$000	0%	$00	$00
7,500	2,500	1	25	25
10,000	2,500	2	50	75
12,500	2,500	3	75	150
15,000	2,500	4	100	250
20,000	5,000	5	250	500
40,000	20,000	8	1,000	2,100
60,000	20,000	12	2,400	4,500
80,000	20,000	17	2,400	7,900
100,000	20,000	22	4,400	12,300
150,000	50,000	27	13,500	25,800
200,000	50,000	31	15,500	41,300
250,000	50,000	37	18,500	59,800
300,000	50,000	42	21,000	80,800
500,000	200,000	46	92,000	172,800
750,000	250,000	50	125,000	297,800
1,000,000	250,000	55	137,500	435,300
1,500,000	500,000	61	305,000	740,300
2,000,000	500,000	62	310,000	1,050,300
Over 2,000,000	......	63		

To this amount add an amount computed as follows: Subtract from the net income (Item O) the sum first found in Column A and multiply the remainder by the rate shown on the next line below in Column C. The sum of these two amounts is the total surtax due.

Calculation of total tax.—Having calculated the amount of surtax, the amount of the total tax due will be arrived as follows:

1. Normal tax of 2 per cent on amount shown on line 25; plus

2. Normal tax of 2 per cent on amount shown on line 27; giving

3. Total normal tax (line 30)

4. Less tax withheld on tax-free covenant bonds (2 per cent on net total of item G); leaving

5. Balance of normal tax due; plus

6. Surtax, plus

7. Excess profits tax of 8 per cent on amount of income in excess of $6,000 shown under Division A.

8. Excess profits tax on income from business with invested capital as computed on excess profits tax return (Form 1001); giving

9. Total tax.

10. Additional or surtax on account of dividends accumulated in 1913, 1914, 1915, or 1916, and partnership profits earned in 1916.

11. Total tax due.

COMPUTATION OF INCOME TAX ON INDIVIDUALS

Example illustrating method.—The following example illustrates the method of computing the tax where certain items of income are taxable at rates other than those in effect for 1917:

A, a married person, a citizen of the United States, has the following income:

From partnership of *A, B & Co.*	$100,000
Interest on bonds	5,000
Stock dividend of 100 per cent on 1,000 shares (par value $100 per share) of the *X, Y, Z Corp.*	100,000
Regular cash dividends on the same stock	10,000
Total income	$215,000

Regarding his income, the following information is available:

Income from the partnership of *A, B & Co.* This income represents a one-half share of the profits for the fiscal year ended March 31, 1917. The Excess Profits tax on the partnership amounts to $20,000.

Interest on bonds. These bonds contain a tax-free covenant clause, and the tax at the rate of 2 per cent has been paid at the source.

Stock dividend. This dividend was paid January 1, 1917. The *X, Y, Z Corporation* distributed a surplus of $10,000,000 by declaring a dividend of 100 per cent on its outstanding stock of $10,000,000.

The surplus account of the corporation during its growth is as follows:

Balance, January 1, 1914	$3,000,000
Added for the year 1914	4,000,000
Added for the year 1915	3,000,000
Added for the year 1916	3,000,000
Surplus, January 1, 1917	$13,000,000

Regular cash dividends. These dividends are the current dividends on the stock of the *X, Y, Z Corporation* paid out of 1917 earnings.

Computation of tax.—Income subject to tax at the rates in effect for the year 1917.

1. Income from partnership of *A, B & Company* $25,000

The partnership books closed March 31, 1917. By the provisions of the law the earnings for the fiscal year are to be prorated between the calendar years 1916 and 1917 on the basis of the number of months in each calendar year. Nine months of the fiscal year are in the calendar year 1916. Therefore, three-fourths of the income of the partnership, or $75,000, is held to be earned in 1916 and is subject only to the taxes in effect for the year 1916.

2. Stock dividend on stock of the *X, Y, Z Corporation*.[1]

[1] See pages 88-98.

An examination of the surplus account of the *X, Y, Z Corporation* on the preceding page makes it evident that no part of the stock dividend was paid out of surplus earned in 1917, for the examination shows that the dividend was declared January 1, 1917, before the earnings for 1917 could be determined. For that reason no part of the dividend is subject to the super-tax imposed by the act of October 3, 1917. The law itself provides that dividends will be treated as having been paid out of the most recently accumulated surplus. Therefore, the dividend in question must be treated as paid out of the surplus accumulated, as follows:

$3,000,000 accumulated in 1916	30%
3,000,000 accumulated in 1915	30%
4,000,000 accumulated in 1914	40%
$10,000,000 total dividend	100%

The law further provides that the dividends should be taxed at the rate in effect for the year in which the surplus out of which they were paid was accumulated. Of the $100,000 stock dividend received, 70 per cent, or $70,000, should be taxed at the rate in effect for the years 1914 and 1915, and $30,000 should be taxed at the rates in effect for the year 1916.

3. Regular cash dividend on the stock of the *X, Y, Z Corporation*	$10,000
4. Interest on bonds	5,000
Total income	$40,000
Less excess profits tax on partnership	10,000
Net income on which income tax will be calculated	$30,000

Calculation of Normal Tax

Income subject to tax		$30,000	
Less deductions:			
Dividends	$10,000		
Personal exemption	2,000		
Total deductions		12,000	
Net income subject to 2 per cent tax.		$18,000	
Normal tax under act of October 3, 1917:			
Tax on $18,000 at 2 per cent.			$360
Less additional exemption of	2,000		
Net income subject to 2 per cent	$16,000		
Normal tax under act of September 8, 1916:			
Tax on $16,000 at 2 per cent			320
Total normal tax		$680	
Less tax withheld at source, 2 per cent of $5,000 (interest on tax-free bonds)		100	
Balance of normal tax due			$580
Super-tax as calculated with use of chart shown on page preceding, on net income of $30,000.			
1. Largest sum in Column A which is less than the amount of the total net income	$20,000		
2. Total surtax thereon shown in Column E		$500	
3. Remainder of net income after subtracting Item 1 above	$10,000		
4. Surtax on this remainder at rate shown in Column C on line below that from which Item 1 was taken		800	
Total surtax due (sum of Items 2 and 4)			$1,300
Additional tax due on income earned in 1914, 1915, 1916, as explained below			7,950
Total tax due			$9,830

Explanation of additional tax. — In arriving at the amount of income subject to tax we omitted certain income because it was earned in 1916 or previous years. The income omitted was as follows:

Earned in 1916.	
Partnership profits	$75,000
Dividends	30,000
Total earned in 1916..........	$105,000
Earned in 1914 and 1915.	
Dividends	70,000
Total income omitted..........	$175,000

Calculation of additional tax on income earned in 1916.	
Normal tax of 2 per cent on $75,000 (partnership profits)	$1,500

(Dividends are not subject to normal tax.)

Super-tax.—This must be calculated on $105,000 of net income in excess of the amount of net income of $30,000, that is, on $105,000, or net income between $30,000 and $135,000 at the rates in effect for 1916.

$30,000 to $40,000......	$10,000	at 1%....	$100
40,000 to 60,000......	20,000	at 2	400
60,000 to 80,000......	20,000	at 3	600
80,000 to 100,000......	20,000	at 4	800
100,000 to 135,000......	35,000	at 5	1,750
	$105,000		

Total super-tax	3,650
Total additional tax on income earned in 1916	$5,150

Calculation of additional tax on income earned in 1914 and 1915.—This must be calculated on $70,000 in excess of the total amount of net income on which the tax has been calculated, that is, on $70,000 of income between $135,000 and $205,000 at the rates imposed by the act of October 3, 1913. These rates are shown by the following chart:

$20,000 to $40,000	1%
40,000 to 50,000	1
50,000 to 60,000	2
60,000 to 75,000	2
75,000 to 80,000	3
80,000 to 100,000	3
100,000 to 150,000	4
150,000 to 200,000	4
200,000 to 250,000	4
250,000 to 300,000	5
300,000 to 500,000	5
500,000 to 1,000,000	6
1,000,000 to 1,500,000	6
1,500,000 to 2,000,000	6
Over 2,000,000	6

The super-tax will be calculated as follows:

$135,000 to $205,000—$70,000 at 4%	$2,800
Total additional tax	$7,950

Assessment of tax.—There is no obligation to pay the tax or any part of it at the time of filing the return with the collector. Assessment is made by the Commissioner of Internal Revenue, and a notice of the amount of the tax is later sent by the collector of internal revenue to the individual on or before June 1 of the year in which the return is filed.

Payment of the tax.—The tax should be paid before June 15th, but no penalty will be incurred for non-pay-

ment until 10 days after notice and demand for the tax by the collector.

Payment of the tax may be made in cash, checks, or the Treasury certificates of indebtedness.

Uncertified checks may now be accepted by collectors in payment of Income and Excess Profits taxes. If such a check is not paid by the bank on which it is drawn, the person by whom it has been tendered remains liable for the payment of the tax and to all the legal penalties or additions to the tax which are provided in case no payment is made.

Advance and partial payments.—The amendment of October 3, 1917, provides for advance installment payments for Income and Excess Profits taxes.

A payment of at least one-fourth of the estimated amount of the tax must be paid within 30 days after the close of the year (i.e., on or before January 30), an additional one-fourth within two months of the close of the year (i.e., on or before February 28); an additional one-fourth within four months after the close of the taxable year (i.e., April 30th), and the balance on or before the time fixed by law (i.e., June 15).—*Income Tax Law, Section* 1009.

Interest allowed on advance payments.—Credit will be allowed on any taxes paid in advance or installments at a rate not to exceed 3 per cent per annum from the date of payment to the date when the tax would otherwise be due (i.e., June 15). No interest will be allowed on payments made after May 15, nor on any payments made in excess of the amount determined to be due.

It should be noticed that by starting to make installment payments the individual obligates himself to continue them, and also makes himself liable to all the penalties for non-payment of the tax if he fails to meet any installment when due.

The following instructions relative to advance payments in installments and in whole of Income and Ex-

cess Profits taxes have been issued by the Treasury Department under Section 1009 of the Act of October 3, 1917:

If taxpayers elect to make advance partial payments on their income or excess profits taxes, or both, as provided by Section 1009 of the Act of October 3, 1917, at least one-fourth of the estimated tax due must be paid within thirty days after the close of the taxable year, at least an additional fourth within two months after the close of the taxable year, and the remainder of the tax due on or before the time now fixed by law for such payment. For the first taxable year, this means in the case of partnerships and corporations who do not fix their own fiscal years and in the case of individuals that at least one-fourth of the estimated tax due must be paid on or before January 30, 1918, at least an additional fourth on or before February 28, 1918, at least an additional fourth on or before April 30th, 1918, and the remainder of the tax due on or before June 15, 1918. In the case of a partnership or corporation whose fiscal year ends July 31, for example, at least one-fourth of the estimated tax due must be paid on or before August 30, at least an additional fourth on or before September 29, at least an additional fourth on or before November 28, and the remainder of the tax due on or before January 12, 165 days after the close of its fiscal year. Taxpayers are not allowed under these regulations to make advance payments in installments or in whole before the close of their taxable year. Upon the first three installments, interest at the rate of 3 per cent per annum (365 days) will be allowed from the date each payment is made to the date now fixed by law for such payment. If the final payment is made within 4½ months after the close of the taxable year, interest at the rate of 3 per cent per annum (365 days) will be allowed from the date of payment to the date now fixed by law for such payment.

In arriving at the amount of the fourth installment required to satisfy the assessed tax, it will be necessary to find the difference between the assessed tax and the sum of the first three installments and the interest at 3 per cent per annum (365 days) on same from the dates of payment to the date now fixed by law for such payment. This difference will be the amount of the fourth installment, if said installment is paid after the expiration of 4½ months after the close of the taxable year, since Sec. 1009 provides that no credit for interest shall be allowed on payments in excess of taxes determined to be due, nor on payments made after the expiration of 4½ months after the close of the taxable year.

If the fourth installment is paid before the expiration of 4½ months after the close of the taxable year, the amount of such installment will be found by dividing the difference mentioned in the preceding paragraph by 1.00 plus the interest at 3 per cent per annum (365 days) on $1 for the number of days from the date on which said fourth installment is paid to date now fixed by law for such payment.

For example, a taxpayer on January 15, 1918, files an income or excess profits tax return showing a tax liability of $4,000 and with the return

makes partial payment of $1,000; February 25, 1918, makes a second payment of $1,000; March 25, 1918, a third payment of $1,000; and the balance May 1, 1918.

The first payment draws interest at the rate of 3 per cent per annum from January 15 to June 15, 151 days (in January, 16; February, 28; March, 31; April, 30; May, 31; and June, 15), or $12.41, amount $1,012.41; the second payment, 110 days (February, 3; March, 31; April, 30; May, 31; and June, 15), or $9.04, amount $1,009.04; and the third payment, 82 days (March, 6; April, 30; May, 31; and June, 15), or $6.74 ($6.739), amount $1,006.74. The sum of the three payments and interest thereon is $3,028.19, making the difference $971.81. The amount to be paid on May 1, 1918, to satisfy this difference is found, by dividing $971.81, by 1.00369863, the "amount" of $1 for 45 days (May, 30; and June, 15), at 3 per cent, to be $968.23 ($968.228).

If, in the example given above, the fourth payment were made May 16, 1917, the taxpayer would be required to pay the whole of the difference, $971.81, as no interest would be allowable on same under the law.

If the taxpayer elects to pay the whole of the tax in advance, that is, after the close of the taxable year and prior to the expiration of 4½ months after the close of the taxable year, the amount to be paid to satisfy the tax will be determined by dividing the amount of said tax by 1.00 plus the interest on $1 at 3 per cent per annum (365 days) for the number of days from the date of payment to the date now fixed by law for such payment.

If the advance payment in whole is made at the time of filing the return, and if upon the examination of such return in this office, it is found that the payment was in excess of the amount required, together with the interest thereon to satisfy the tax actually due, the taxpayer will be entitled to the refund of the amount of excess payment (but not the interest thereon) by making claim for same on Form 46.

In arriving at the amount of excess payment, the tax assessed should be divided by 1.00 plus the interest at 3 per cent per annum (365 days) on $1 for the number of days from the date of payment to the date now fixed by law for such payment. The difference between the amount actually paid in advance and the quotient will be the amount of excess payment.

The interest at the rate of 3 per cent per annum (365 days), allowed to a taxpayer on advance payments on income and excess profits taxes, must be considered income and accounted for as income by the taxpayer in his return for the year in which said interest is allowed.

INTEREST TABLE

INTEREST ON $1.00 AT 3 PER CENT. PER 365 DAYS, 1 DAY TO 165 DAYS

Days	Interest	Days	Interest	Days	Interest
1	$0.000082192	56	$0.004602740	111	$0.009123288
2	.000164384	57	.004684932	112	.009205479
3	.000246575	58	.004767123	113	.009287671
4	.000328767	59	.004849315	114	.009369863
5	.000410959	60	.004931507	115	.009452055
6	.000493151	61	.005013699	116	.009534247
7	.000575342	62	.005095890	117	.009616438
8	.000657534	63	.005178082	118	.009698630
9	.000739726	64	.005260274	119	.009780822
10	.000821918	65	.005342466	120	.009863014
11	.000904110	66	.005424658	121	.009945205
12	.000986301	67	.005506849	122	.010027397
13	.001068493	68	.005589041	123	.010109589
14	.001150685	69	.005671233	124	.010191781
15	.001232877	70	.005753425	125	.010273973
16	.001315068	71	.005835616	126	.010356164
17	.001397260	72	.005917808	127	.010438356
18	.001479452	73	.006000000	128	.010520548
19	.001561644	74	.006082192	129	.010602740
20	.001643836	75	.006164384	130	.010684932
21	.001726027	76	.006246575	131	.010767123
22	.001808219	77	.006328767	132	.010849315
23	.001890411	78	.006410959	133	.010931507
24	.001972603	79	.006493151	134	.011013699
25	.002054795	80	.006575342	135	.011095890
26	.002136986	81	.006657534	136	.011178082
27	.002219178	82	.006739726	137	.011260274
28	.002301370	83	.006821918	138	.011342466
29	.002383562	84	.006904110	139	.011424658
30	.002465753	85	.006986301	140	.011506849
31	.002547945	86	.007068493	141	.011589041
32	.002630137	87	.007150685	142	.011671233
33	.002712329	88	.007232877	143	.011753425
34	.002794521	89	.007315068	144	.011835616
35	.002876712	90	.007397260	145	.011917808
36	.002958904	91	.007479452	146	.012000000
37	.003041096	92	.007561644	147	.012082192
38	.003123288	93	.007643836	148	.012164384
39	.003205479	94	.007726027	149	.012246575
40	.003287671	95	.007808219	150	.012328767
41	.003369863	96	.007890411	151	.012410959
42	.003452055	97	.007972603	152	.012493151
43	.003534247	98	.008054795	153	.012575342
44	.003616438	99	.008136986	154	.012657534
45	.003698630	100	.008219178	155	.012739726
46	.003780822	101	.008301370	156	.012821918
47	.003863014	102	.008383562	157	.012904110
48	.003945205	103	.008465753	158	.012986301
49	.004027397	104	.008547945	159	.013068493
50	.004109589	105	.008630137	160	.013150685
51	.004191781	106	.008712329	161	.013232877
52	.004273973	107	.008794521	162	.013315068
53	.004356164	108	.008876712	163	.013397260
54	.004438356	109	.008958904	164	.013479452
55	.004520548	110	.009041096	165	.013561644

CHAPTER VII

CORPORATION INCOME TAX

CORPORATIONS AND ASSOCIATIONS SUBJECT TO TAX

Income Tax laws.—The Income Tax law of September 8, 1916, levies a tax upon the net income of every corporation, joint-stock company or association and insurance company organized in the United States, no matter how organized or created. The War Income Tax law of October 3, 1917, imposed an additional tax upon all organizations subject to the tax under the 1916 law.

Partnerships pay tax as individuals.—The partnership form of organization is not included in the list of organizations subject to the corporation income tax. No income tax return is required of partnerships as such, the individual members of the partnership being taxed for their respective shares of the net income.

Limited partnerships are associations.—Limited partnerships, however, are held to be associations within the meaning of the Income Tax Law and, for income tax purposes, are treated as corporations.

Joint-stock company or association.—The term "joint-stock companies or associations" includes associations and real estate trusts, commonly known as Massachusetts Trusts, whether organized under State laws, trust agreements, declarations of trust or otherwise. They will be taxed as associations in all cases where the net income is distributed or distributable on the basis of stock holdings in, or capital contributed to, the organization.[1]

[1] A Massachusetts Trust is a form of organization in which title to property is vested in trustees for the benefit of the members. Each mem-

Every corporation must file return.—Every corporation, unless specifically enumerated as exempt, must make a return of its annual net income required by law whether or not it has any income liable to tax or whether or not it is subordinate to or controlled by another corporation.

Moreover, the tax is imposed not only on those corporations that are organized and operated for profit, but also on any corporation, joint-stock company or association, and any insurance company, no matter how created or organized, or what the purpose of its organization may be, unless it comes within the class of organizations specifically enumerated in the act as exempt. And such organizations will be required to make returns of annual net income and must pay an income tax upon the net income which arises and accrues to them during the year.

Corporation subsidiaries. — Every corporation, joint-stock company or association, and every insurance company regardless of its relation to another corporation, is a separate and distinct entity and unless it comes within the class of exempt organizations, it must make a separate and distinct return, complete in every detail. The net earnings of the subsidiary company, turned over to the parent company, are dividends within the meaning of the 1913 and 1916 laws, and as such dividends are not deductible from gross income, the parent com-

ber receives a certificate of beneficial interest in the property of the "trust."

Under the decision of *Eliot vs. Freeman, et al* (220 U. S., 178), Massachusetts Trusts were not subject to the tax imposed by the act of August 5, 1909. This exemption does not apply to the present corporation income tax. The 1909 tax was imposed on all corporations *organized* in the United States, including Alaska and the District of Columbia, and as Massachusetts Trusts are not organized under the laws of any State, they were not subject to the tax.

The 1913 Income Tax law and all subsequent laws have levied taxes on all corporations or associations no matter how organized or *created.* Clearly the use of the word "created" was intended to obviate the decision in the Eliot case, and it therefore follows that Massachusetts Trusts are not exempt.

pany must pay the tax on its net income notwithstanding the fact that the earnings of the subsidiary out of which the dividends were paid had been subject to tax as against the subsidiary. The Income Tax law specifically sets forth that there shall be returned, as gross income, all income received from all sources during the year, for which the return is filed, and it specifically enumerates the items which may be deducted from such gross income There is no provision in the act of September 8, 1916, whereby dividends received from other corporations may be excluded from gross income or deducted therefrom. Every corporation is a separate and distinct entity and, for the purpose of the tax, must report the income which it receives (except interest on obligations of the United States, a State or subdivision thereof) regardless of the source from which such income is received and regardless of the fact that a portion of such income may constitute dividends from other corporations subject to like tax.

Section 4 of the War Income Tax added by the act of October 3, 1917, imposing an additional 4 per cent income tax on corporations recognizes this double taxation and allows as a credit, before the computation of the additional 4 per cent tax, the amount received as dividends upon the stock or from the net earnings of any other corporation which is taxable upon its net income as provided in Title I of the War Income Tax act.

Thus, in the case of a parent corporation owning all or practically all of the stock of subsidiary companies, both corporations are considered separate and distinct entities, and each must make a true and accurate return, accounting for, in detail, the separate gross incomes and deductions. Each company will be required to pay the income tax on the net earnings shown by individual report (subject to the above allowance.) The mere fact that the subsidiary is maintained simply for

the purpose of protecting certain brands, trade-marks, or trade names is immaterial and such a company is required to make a return. Even if such a company has no income or earnings and its operating expenses are paid by the parent company, the subsidiary must make a return clearly setting forth these facts.

On the other hand, if the subsidiary concerns are mere partnerships or branches of the parent company, and not separately incorporated organizations, they will not be required to make reports of annual net income, but all of their earnings and expenses should be taken up and accounted for in the report of the parent organization.

Close corporations must file returns.—Very often a corporation is formed as a family affair, with the idea of keeping the ownership in the hands of two or three individuals. Such a corporation does not come within the classification of exempt corporations and is therefore required to make a return of annual net income, which will show all the income arising and accruing to it from all sources. The mere fact that the stock of the corporation is kept by a few people and not generally bought and sold does not affect the status of the corporation.

Corporations owned by exempt organizations must file returns.—If all of the stock of a non-exempt corporation is owned by a corporation which comes within the exempt classification, the former corporation is not relieved from liability under the tax law. The income tax liability of a corporation does not depend upon the ownership of its stock.

Corporations in existence for only part of the year must file returns.—All corporations, unless exempt, in existence during all, or any part of a taxable year, are required to make returns for that year. Dissolved corporations whose fiscal year coincides with the calendar year must make returns covering the period from Janu-

ary 1st to the date of dissolution. Defunct corporations which had a fiscal year other than the calendar year should make returns covering the period from the beginning of the fiscal year to the date of dissolution. New corporations should make returns for the period from the date of their organization to December 31, unless they have designated some other date as the close of their fiscal year, and have received permission from the collector to file return as of a fiscal year, in which case a return should be made covering the period from the date of organization to the close of the fiscal year.

Corporations dissolving or liquidating during the year may, at the time of dissolution or liquidation, make and file a final return covering the income received or accrued to them during the fractional part of the year in which they were engaged in business. If the return shows a net income for that portion of the year during which the corporation was in business, the proper officers of the corporation should retain sufficient funds out of which the income tax assessment can be paid. If funds for this purpose are not retained the tax office will look to the officers of the corporation for the payment of the tax shown to be due. Should they fail to pay the tax the government may look to the stockholders for its payment.

Corporations that have dissolved prior to October 3, 1917, are held to be liable for the normal income tax of 2 per cent under the act of September 8, 1916, the War Income tax of 4 per cent under the act of October 3, 1917, and for the War Profits tax, also imposed under the act of October 3, 1917.

Corporations organized but not transacting business must file returns.—A corporation which has been fully organized, but which has transacted no business during the year of its organization or any subsequent year, must nevertheless, make and file a return.

Corporations not entirely organized need not file returns.—Corporations which have applied for and never received charters, or corporations which have received charters and never perfected their organizations, transacted no business and had no income whatever from any source may, upon presentation of these facts to the collector, be relieved from the necessity of making returns of annual net income so long as they remain in this unorganized condition. Of course, if the corporation is completely organized, even though it had no income during the year, it must file a return.

Corporations engaged in agricultural pursuits for profit must file return.—Corporations engaged in agricultural or horticultural pursuits for profit are liable under the law to make returns and to pay the income tax. Thus, corporations owning sugar or other plantations and selling the product are considered to be operating for profit and are not entitled to exemption as agricultural organizations.

Corporations leasing their property.—A railroad or other corporation which has leased its properties in consideration of a rental equivalent to a certain rate of dividend on its outstanding capital stock or the interest on its bonded indebtedness or both, such rental being paid by the lessee directly to the stock and bondholders, should nevertheless make a return of annual net income showing the rental so paid as having been received by the corporation.

In paying, as rent, dividends or interest directly to the shareholders or bondholders of the lessor company, the lessee company is held to be acting merely as the agent of the lessor company. The lessor company must, of course, render an income tax return which will show as gross income the amount of rentals paid by the lessee company to the stockholders and bondholders of the lessor company. The interest can then properly be deducted as an expense.

Corporations operating leased properties.—Where a corporation leases property which it operates, the rental payment is an operating expense and as such may be deducted. Even if the rental payment is measured by a fixed percentage of the stock of the lessor company and is paid as dividends to the stockholders of the lessor company, the rental payment is an expense deductible from the gross income of the lessee company.

Private banks with corporate form of organization.—Private banks which have the form of corporate organizations, elect officers and a board of managers, have a distinctive name, a fixed situs, and distribute their net earnings upon the basis of the amount of capital invested by the members or owners, are held to be associations, and in their organized capacity must file a tax report and pay the tax on the same basis as do corporations. On the other hand, private banks which do not have this formal organization, but which transact business, not in the name of the bank, but in the name of the individuals who compose the firm, are copartnerships, and as such are not required to make a return. Each of the individuals comprising such a partnership will be required to render an individual income report and pay the individual income tax thereon.[1] Of course if the private bank is a limited partnership it is subject to the corporation income tax.

Foreign corporations may be subject to tax.—Corporations, joint-stock companies or associations and insurance companies, organized, authorized or existing under the laws of any foreign country must report and pay a tax upon the amount of net income accruing from business transacted and capital invested within the United States. In case such a corporation has several branches in the United States, it should designate one of them as the principal branch and have it render a report covering the income of all branches in this country.

[1] See page 71.

Even if a foreign corporation does not, strictly speaking, have a branch office in the United States, but transacts business or has capital invested in the United State through and by an agent, it will be subject to the tax just as though it were transacting business or investing the capital direct from the home office or through regular branches. Any net income arising or accruing from the business of such an agent will be subject to the corporation income tax; and it is the duty of the foreign corporation in such a case to render a report of the business transacted through the agent. And so, too, when a foreign corporation sends a representative to the United States to solicit business, with the understanding that the goods are to be shipped direct to the purchaser, it is held that such a corporation is doing business in this country and must pay a tax on the net income arising or accruing to the corporation from such transactions. The mere fact that the solicitor has only a mailing address in this country makes no difference, for he is still held to be an agent of the foreign corporation.

CORPORATIONS EXEMPT FROM THE INCOME TAX

Corporations which are exempt from income tax.—Certain corporations and organizations are entirely or conditionally free from income taxes, and are not required to render income tax reports. The law itself, Section 11, lists such corporations and organizations. The exemption from the payment of taxes applies not only to such domestic corporations as are enumerated in section 11 of the law, but also to foreign corporations which come within the definition of exempt organizations. In any event, a corporation which claims to come within the exempt classifications of section 11 of the law should file, with the Collector of Internal Revenue, an affidavit showing the basis of its claim for exemption. This affidavit must include:

1. The purpose and nature of the organization.

2. The source of its income.

3. The disposition of its income.

4. Whether or not any of its income will ever inure to the benefit of any private stockholder or individual.

5. If the organization is a foreign organization and doubt exists as to whether or not it is exempt, there should be attached a copy of its charter and by-laws.

If the affidavit thus submitted is not satisfactory the organization may be required to file a report. If it is satisfactory and the organization comes within the exempt class, the organization will be definitely advised as to its status.

Labor, agricultural, or horticultural organizations.—Labor unions and similar labor organizations are exempt. Agricultural and horticultural associations which are also exempt, include such associations as county fairs or like organizations not themselves engaged in agricultural or horticultural pursuits, but which by means of awards, premiums, etc., attempt to encourage better production. To be exempt, however, no part of their income may inure to the benefit of any private stockholder or individual.

Fruit growers associations, whose purpose it is to promote the mutual benefit of their members in marketing their products and which are not organized for profit and have no capital stock represented by shares, and whose income is derived wholly from membership fees, dues, and assessments to meet necessary expenses, are also horticultural societies within the meaning of the law. They are not subject to tax nor are they required to make a report of their income. They should, however, file the affidavit mentioned in the preceding paragraph.

Mutual savings banks not having a capital stock represented by shares.—Any mutual savings bank organized

merely for the purpose of affording a means of mutual savings and investment is exempt from the income tax.

Fraternal beneficiary societies.—Any beneficiary society, order or association operating under the lodge system and providing for the payment of life, sick, accident or other benefits to the members of such societies, orders or associations or their dependents are exempt. Of course, in this exemption are included all societies or associations operating under a charter with properly appointed or elected officers, with an adopted ritual or ceremonial, holding meetings at stated intervals, and supported by fees, dues or assessments.

Building and loan associations and co-operative banks.—Domestic building and loan associations, and co-operative banks without capital stock, organized and operated for mutual purposes and without profit, are exempt from the tax.

A domestic building and loan association is one organized under the laws of the United States or of a State or Territory of the United States, or under the laws applicable to Alaska or the District of Columbia. To be exempt it is absolutely essential that the building and loan association be "mutual" in its operation and in its distribution of profits and benefits. Therefore, in order to come within the exempt class such associations must not only be "domestic," as defined, but they must be operated exclusively for the mutual benefit of the members. All the profits and benefits provided for in the articles of association and by-laws must be ratably distributed among all the members regardless of the kind of stock held, according to the amount of money they have on deposit. If an association issues different classes of stock upon which different rates of interest or dividends are guaranteed or paid, it does not come within the exempt class. Or if one class of stock is preferred in dividends or otherwise over another class, the association would not be

exempt. But the mere fact that an otherwise "mutual" building and loan association issues two classes of stock, one of which is paid for in full at the time of issue, and the other of which is paid for in installments, does not affect the "mutuality" of the association.

Cemetery companies.—Cemetery companies, organized and operated exclusively for the mutual benefit of their members are exempt. But the provisions of the law clearly indicate that companies which operate cemeteries for profit are liable to the tax. The taxability of cemetery associations, therefore, depends upon the character and purpose of the organization and what disposition is made of the income. To obtain exemption, a mutual cemetery company should file the necessary affidavit showing the basis of its claim for exemption.

Religious, charitable, scientific and educational associations.—Corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual are exempt.

Under this heading are included churches, leagues, chambers of commerce or boards of trade, not organized for profit and no part of the net income of which inures to the benefit of any private stockholder or individual. Of course private schools which are run for profit and for the private gain of stockholders or individuals are not exempt.

Civic leagues.—Civic leagues or organizations not organized for profit, but operated exclusively for the promotion of social welfare, are exempt.

Pleasure and social clubs.—Social clubs which are organized and conducted exclusively for pleasure, recreation and other non-profitable purposes and which have no net income inuring to the benefit of any private stockholder, individual, or member, are exempt. But all

clubs are not exempt from the provisions of the Income Tax law, and this is true even though they are not operated for profit. A club which desires to be exempt and to be registered as an exempt organization should file with the Collector of Internal Revenue either a copy of its charter, or an affidavit of its principal officer, setting forth the facts required in such affidavits.[1] This is required even in the case of clubs operated for purely social purposes. If such an affidavit is not filed it may be necessary for the club to file an income tax return.

Mutual insurance, irrigation, telephone and other local mutual companies.—Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or co-operative telephone companies, or like organizations of a purely local character, the income of which consists solely of assessments, dues and fees collected from members for the sole purpose of meeting its expenses, are exempt.

Some trouble may be experienced by readers in determining just which mutual companies are exempt, since it is quite evident from other parts of the law (for example, Sec. 12a, second) that this clause does not exempt all mutual insurance companies. A strict application of the law is necessary, the test being in each case, does the company fit the following four requirements:

(1) Is it mutual or co-operative?

(2) Is it a purely local association?

(3) Does it derive its income wholly from assessments, dues and fees?

(4) Is the income thus derived used for the sole purpose of meeting its expenses?

If, for example, such a corporation should derive income from an investment owned by the company, it would cease to be exempt.

[1] See following page.

Farmers' and fruit growers' associations. — Farmers', fruit growers' or like associations, organized and operated as sales agents for the purpose of marketing the products of their members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them, are exempt. So also are farmers' co-operative dairy associations which are organized and conducted solely to sell the milk of their members for their mutual benefit.

Certain realty corporations exempt.—Corporations or associations organized for the exclusive purpose of holding title to property, collecting income therefrom and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax, are exempt.

Federal land banks and national farm loan associations are exempt.—Federal land banks and national farm loan associations organized and operated under the provisions of the Federal Farm Loan Act (section 26 of the act approved July 17, 1916, entitled "An Act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgages, to equalize rate of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States and for other purposes," are entirely exempt from income taxes. Joint-stock land banks are also exempt as to income derived from bonds or debentures of other joint-stock banks or of any Federal land bank belonging to such joint-stock land banks.

Proof of exemption is required.—The classes of organizations enumerated hereinbefore comprise all of the forms of organizations that are exempt from the income tax. It must be borne in mind, however, that the tax is imposed not only on corporations which are operated for profit, but on all corporations, associations,

joint-stock companies, and insurance companies, no matter what the purpose of their organization, unless they are included in one of the foregoing groups.

All corporations and all beneficiary societies which claim exemption must, at the request of the Collector or Commissioner, establish their right to the exemption by showing not only the character and purpose of the organization and the manner of distributing the net income, but also that none of the net income inures to the benefit of any private stockholder or individual.

In the absence of such a showing such an organization may, at any time, be required to make returns of annual net income or show its books of account to a revenue officer for examination, in order that the status of the company may be determined.

If a corporation or beneficiary society once satisfies the Collector or Commissioner that it is exempt, it will not be required to make any further showing or file any additional affidavits unless the Collector or the Commissioner has reason to believe that the status of the organization has changed or that it has a net income inuring to the benefit of a private stockholder or member.

Income accruing to a State from public utility corporations is exempt.—The income of any State or political subdivision is exempt from the tax; Congress has no authority to levy any tax upon the States themselves. It follows, therefore, that if a city operates a public utility the income accruing to the city from such utility is exempt.

It is becoming increasingly common for cities to build or operate public utilities in connection with a private corporation on what amounts to a partnership basis. To cover such situations the Income Tax law, section 11, subdivision (b) provides that in those cases where a State, territory or any subdivision has, before September 8, 1916, made a contract with an individual,

partnership, corporation, or other business association to operate a public utility, and such contract gives the State, territory or other subdivision a share in the profits, such share of the income from the operation as accrues to the city should be deducted by the individual or corporation operating the utility in computing the net income subject to the income tax. The State or its subdivision therefore receives its share of the profits unburdened with the tax.

To illustrate: A city has an agreement with a corporation to operate a street railway, the city to receive one-third of the profits. The profits for the year 1917 amount to $300,000. The corporation in making up its income tax return would deduct the city's share of the profits, or $100,000, and show a net income of $200,000, on which it would pay the tax. The city receives its $100,000, and pays no tax thereon.

It would seem that only such income is exempt as is paid to a State or subdivision thereof under a contract entered into *prior* to the passage of the act (Sept. 8, 1916). That at least is what the law plainly says. Probably, however, the same rule would apply to cases where contracts are entered into subsequent to the passage of the act, for otherwise the income tax would be a burden on State revenues and to such an extent invalid.

"Income accruing to the Government of the Philippine Islands or Porto Rico, or any political subdivision" thereof is also exempt under this provision of the law.

CHAPTER VIII

CORPORATION INCOME TAX

GROSS INCOME

Classification of gross income.—The gross income of a corporation may be classified under the following headings:

Gross income:

(a) From operations.
(b) From rentals.
(c) From interest.
(d) From dividends received.
(e) From other sources.

Income to be computed on an established basis.—The law allows a corporation, joint-stock company or association, or insurance company to compute its income upon a basis of actual receipts and disbursements, and report simply the cash or other income actually received. But in the usual case, where a corporation keeps its books in accordance with any standard system of accounting on the so-called accrual basis, the corporation may report income earned although not yet received, and expenses incurred although not yet paid. Or if a corporation keeps its books in conformity with the requirements of any Federal, State or municipal authority, it may make its return on the basis on which its books are kept.

While no particular system of bookkeeping or accounting is required by the law, the books of the cor-

poration should be so kept that every item set forth in the income tax report may be verified by an examination of the books. If they are so kept they will be looked upon by the Government as being the best guide in determining the net income of the corporation.

And this net income shown by the books, or in the annual report to stockholders of a corporation, should be the same as shown in the tax return, except in those cases where the income tax law excludes certain income and limits certain deductions from gross income.

INCOME FROM OPERATIONS

Gross income from operations.—This includes all gross income resulting from the operations of the corporation. A supplementary statement is required of all manufacturing and mercantile corporations which determine their annual gain or loss by inventory, showing the method of arriving at their gross income from operations.

Inventory method of determining gain or loss.—Most manufacturing and mercantile corporations determine their profit by means of an inventory. The business man engaged in a mercantile business generally determines his gross income as follows:

Sales during the year		$50,000
Cost of sales:		
Inventory at the beginning of the year	$15,000	
Purchases during the year	25,000	
	$40,000	
Less inventory at the end of the year	10,000	
Cost of goods sold		30,000
Gross income from operations		$20,000

Sales during the year.—By the amount of sales during the year is meant net sales, that is, the total sales less sales returns. Trade discounts on sales should

also be deducted before stating the net sales, for the trade discount is simply a reduction of the selling price.

Allowances on sales for damages to or losses of goods sold should also be deducted before stating the net sales. Cash discounts taken by customers for payment before due date of bills should be included under general expenses and not deducted from gross sales.

Inventory at the end of the year.—The value that is placed upon the merchandise on hand at the end of the year is a deciding element in determining gross profit. The best accounting authorities hold that the inventory should be valued at cost or at market value, whichever is lower. To illustrate: If an article is purchased for 75 cents and the market value at the time of inventory is 70 cents, the inventory value should be 70 cents, but if at the time of inventory the market value were 85 cents, the cost price, or 75 cents, would be used.

The rulings of the Treasury Department in the past have not been in accord with that principle. The Department held until recently that the inventory should be figured at cost price, regardless of what the market price might happen to be. The reason given by the Department was that the profits or losses resulting from considering the increases or decreases in inventory values were not actual profits or losses, but merely book appreciation or depreciation of values, which might entirely disappear upon the sale of the products so inventoried, and that actual profit or loss could not be determined until the merchandise was actually sold or disposed of; also that the profit or loss would at any rate be reflected in the report of the subsequent period or periods and a tax imposed or a deduction allowed in the period.

The valuing of inventory at cost regardless of the market price works a hardship in a declining market, because the amount of tax cannot be properly adjusted

from year to year. To illustrate: For the year 1915 the income of corporation A was as follows:

Sales	$100,000	
Inventory at the end of the year, cost $40,000 (market value, $25,000)	40,000	$140,000
Purchases during the year	$75,000	
Inventory at the beginning of the year	35,000	110,000
Gross income		$30,000
Expenses		10,000
Net income		$20,000

For the year 1916 the income was:

Sales	$80,000	
Inventory at the end of the year, cost $40,000 (market value, $40,000)	40,000	$120,000
Purchases during the year	$75,000	
Inventory at the beginning of the year	40,000	115,000
Gross income		$5,000
Expenses		10,000
Net loss		$5,000

The corporation by complying with the Department's rulings then showed an income for the year 1915 of $20,000 on which it had to pay an income tax. For 1916 there was a loss of $5,000 by the corporation, but it did not receive a refund on the tax paid for the previous year. The result was that the corporation had a net income for the two years of $15,000, but it was compelled to pay the tax on an income of $20,000, which was, obviously, unfair.

If the inventory at the end of 1915 had been figured at the market price of $25,000, the profit for 1915 would have been reduced to $5,000 and, correspondingly, the loss for 1916 would have been turned into a profit of $10,000. The combined net income for the two years would of course be the same as by the other method, but the corporation would pay the tax only on the amount of net income it had earned, or $15,000.

The protests against the old ruling eventually became so strong that the Treasury Department changed its attitude. For the year 1917 individuals, partner-

ships, and corporations in computing their net income may calculate the inventory of merchandise or stock in trade on hand either (1) *at cost* or (2) *at cost or at market value*, whichever is lower. This ruling brings the Department in accord with the majority of business men. Whichever basis is chosen must, however, be used consistently in making subsequent returns.

While the Department states that, as between the cost and the market value, the lower figure may be used on the income tax return, it does not require that the same method be used on the books of the corporation. The use of the lower figure on the return does not prevent the use of the higher figure on the books of the individual, partnership, or corporation. But it must be remembered that where returns are investigated the burden of showing that the inventory figure appearing on the books should not be used in computing the income, for the purpose of the income tax is upon the taxpayer. In such cases the taxpayer should calculate the inventory on both bases (cost price and market value) in order to protect himself should his books be examined by the Treasury Department.

Only "stock in trade" may be inventoried at market.—Only such articles or items as constitute stock in trade may be inventoried at market value. A dealer in securities may inventory unsold securities at market value (when the market value is less than the cost price) only if he regularly inventories them at the same figure upon his books of accounts. But a mercantile corporation must inventory any securities it owns at cost, because securities are not part of its stock in trade.

"Dealer in securities" defined.—A "dealer in securities," permitted to inventory his securities at cost, must be a merchant of securities, with an established place of business, whose principal business is the purchase of securities and their resale to customers. Such a dealer

may be either an individual, a partnership, a corporation, or other form of business association. A person who buys or sells securities only for his own account, for speculation or investment, would not be classed as a "dealer in securities," and is not entitled to the option of valuing his securities either at cost or at market price, but is required to inventory them at cost. Moreover, members of firms and officers of corporations which are "dealers in securities" are not themselves classed as such dealers, when acting in their individual capacities. Hence as individuals they must inventory any securities they own at cost.

Methods of taking inventory.—The inventory itself may be made in different ways. Of course the most satisfactory method is the taking of an actual physical inventory. This is the method the government prefers, and it is obviously the most accurate method for any business man to follow. However, in place of a physical inventory, an "equivalent" method that is "equally accurate" may be used. While perhaps there is no method quite so accurate as the physical stock taking method, the government considers "an inventory of materials, supplies and merchandise on hand taken from the books of the corporation," satisfactory.

Practical considerations governing inventory valuation.—While the new decision gives every merchant the option of deducting from his taxable income any loss he may have sustained due to a decrease in the market value of his merchandise or stock inventory, it is not always advisable for the merchant to exercise this option. It is well to bear in mind that the inventory figure reported at the end of one year must be used as the inventory figure at the beginning of the following year. It is obvious, therefore, that any deduction from inventory valuations one year will be reflected in the following year's report, showing a corresponding increase in the income for the following year.

Therefore, it is often better (to save taxes in a subsequent year) to value inventories at cost, even when market value is lower. Obviously, this is true when, even if the inventories are valued at cost, no profit will be shown. The loss in inventory value can then be deducted in some subsequent year (when the goods are sold below the cost), and diminish the taxable profits for that year.

Moreover, if the profits are small this year, and much larger profits are anticipated the following year, it would probably save super-taxes, or excess profits taxes, in the later year to inventory the goods at cost this year.

But if the company cannot afford to pay much in taxes this year, it should inventory its goods at market price (if market price is lower than cost) so as to keep down its taxable profits this year. The effect of valuing inventories at market price, when that is lower than cost, is to decrease taxable profits for the current year, and practically to increase taxable profits for a future year.

From a taxpayer's standpoint it is often advisable to ask himself the following question: "Should I inventory my goods at market price (if market price is lower than cost), and thus save taxes this year, and take a risk on next year's taxes, or should I inventory my goods at cost, assuming my profits will be larger or the tax rate will be greater next year?"

Purchases during the year.—The amount of "purchases during the year" is the gross price of purchases less returns of goods purchased, and less trade discount on goods purchased. Cash discounts on purchases are properly included under "income from other sources."

A manufacturing corporation may include under purchases, the supplies, etc., used in manufacturing, as well as purchases of raw material. Where supplies and other items of expense are included in purchases

they should not be included elsewhere in the report as an expense.

Inventory method as applied to manufacturing corporations.—In the case of a manufacturing corporation, the inventory includes not only the raw material purchased but also the material which is in the process of manufacture and finished goods. For example, the gross income of a manufacturing corporation would be determined as follows:

Sales			$50,000.00
Cost of Sales:			
Inventory at beginning of period:			
Raw materials	$15,000.00		
Work in process	25,000.00		
Finished stock	10,000.00		
		$50,000.00	
Purchases		45,000.00	
Cost of manufacturing or producing goods		10,000.00	
		$105,000.00	
Less inventory at end of period:			
Raw material	$10,000.00		
Work in process	20,000.00		
Finished stock	35,000.00		
		65,000.00	
Cost of goods sold			40,000.00
Gross income from operations			$10,000.00

Valuation of manufacturers' inventories.—The inventory of a manufacturing corporation may be divided into three parts: raw materials, goods in process, and finished goods.

No difficulties need arise in determining the cost of raw materials. Invoices or stock records will furnish the necessary figures. Or if the market value is lower than cost, the market value may be used.

The difficulties arise in connection with goods in process and finished goods. The cost of a manufactured article is composed of three elements: materials, labor, and overhead. Prior to the introduction of cost accounting the valuation of goods in process and of finished goods was more or less an estimate. Material

and labor were the only items of cost considered. Where cost accounting systems are in use, the cost can be accurately determined, because every article produced is charged not only with the material used and with the labor expended upon it, but also with a portion of the expense of maintaining the factory and other overhead.

Overhead itself may be divided into two classes: factory overhead, which includes the expenses incurred in the operation of the manufacturing plant, and general overhead, which includes all administrative and selling expenses. Only the first class of overhead should be added to the cost of the merchandise in order to determine the inventory value of the goods in process and the finished stock. General overhead should properly be shown under the separate captions included under the head of "General Expenses."

The inventories of goods in process and of finished goods may also be valued at the market price, when such value is less than the cost. As a rule no market exists for goods in the process of manufacture, and therefore there is no market value of such articles. But a market value may be estimated on the basis of the market value of the items entering into the goods in process and this estimated market value may be used when it is lower than the cost price.

Gross income of other corporations.—Where the income is not directly related to the amount of material used the gross receipts may be considered gross income, and any materials used may be deducted as expenses. Printers and newspaper publishers, for example, use a considerable quantity of paper, yet the cost of the paper is not the determining factor of the amount of income. They are justified in considering their gross receipts as income and the cost of paper used as an expense incurred in earning the income.

As was pointed out hereinbefore, the law allows the

utmost freedom as to the method of accounting to be followed. The only restriction is that the books must reflect the true income of the corporation.

The question as to whether or not certain items should be included as income is very often one of accounting principles rather than one of the interpretation of the law. The net income of a corporation at times cannot be finally determined until all its assets are liquidated. Any statement of net income prior to the liquidation of the affairs of the corporation is necessarily only an estimate. Accounting has developed a number of well recognized principles or rules to be followed in determining net income, and these rules have been, with one or two exceptions, accepted by the Department. These principles and the exceptions are brought out in the text where necessary.

Take the case of a contracting corporation which has numerous uncompleted contracts which in some cases run for periods of several years. In this case there is no objection on the part of the Treasury Department to preparing a return in such manner that the gross income will be arrived at on the basis of completed work, that is, on contracts which have been finally completed and payments made during the year for which the return is made. If the gross income is arrived at by this method, the deductions or expenses should be limited to the expenditures made on account of such completed contracts.

In all cases where the gross income is arrived at by a method other than the "inventory" method, the exact method used should be explained on the report.

Gross income of insurance companies.—The income of insurance companies is so different from that of the ordinary mercantile or trading corporations that the Treasury Department has issued a special form of return, and has issued also a number of special regulations governing their return of income.

Gross income of insurance companies consist of the total revenue derived from the operation of the business, including income, gains, or profits from all other sources, as shown by the entries on the books of account within the calendar or fiscal year for which the return is made, except as modified by the express exemptions of the articles which apply to mutual fire, mutual marine, and life insurance companies. The return must be made in conformity with the reports for the same year made to the Insurance Department of the State in which the company is organized.

Mutual fire insurance companies.—Mutual fire insurance companies which require their members to make premium deposits to provide for losses and expense, need not return as gross income any portion of the premium deposits returned to their policyholders, but should return as taxable income all income received by them from all other sources, plus such portions of the premium deposits as are retained by the companies for purposes other than paying losses and expenses incurred during the year for which the return is made and for such reinsurance reserves as the laws of the State require.

Therefore, if mutual fire insurance companies retain out of moneys received on account of assessments an amount in excess of the losses, expenses, and reinsurance reserves of any particular year, that excess, plus amounts received from interest, dividends, or any other source, will be the net income upon which the tax will be assessed.

Mutual marine insurance companies.—Mutual marine insurance companies are required to include as gross income gross premiums collected less amounts paid by them for reinsurance. They are, however, allowed to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid on such unusued premiums.

Life insurance companies.—Life insurance companies are allowed to omit from gross income "such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to the policyholder or treated as an abatement of premium of such individual policyholder."

Deferred dividends payable at a stated period and representing a "portion of any premium received" and actually paid back, credited to the policyholder or applied as an abatement of premium, may be included in the amount to be omitted from gross income. Only the amount credited or apportioned during the premium-paying period, and not any interest on such amounts, may be excluded from gross income.

RENTS, ROYALTIES AND INTEREST

Income from rentals.—All payment received in cash or its equivalent as rent of buildings or property owned by the corporation must also be reported. The rent itself need not actually be received directly by the corporation. For example, a corporation that has leased its properties in consideration of a rental equivalent to a certain rate of dividend on its outstanding stock and the interest on its bonded indebtedness, where such rental is being paid by the lessee directly to the stock and bondholders, should make a return of net income showing the rental so paid as having been received by the corporation.

In such cases, there are two corporations involved, one the lessee and the other the lessor. One is the rent payer; the other is the rent receiver. To the lessee, rental payments are an expense of operation; to the lessor, the rentals are an income.

Where a corporation leases property on the condition that a certain fixed sum be expended by the tenant in making improvements, the building or other improvements reverting to the corporation at the termination of

the lease, the value of the improvements is, in reality, a part of the rent received by the corporation.

The value of the improvements need not be reported as income until the expiration of the lease. The gain would be the difference between the cost of the improvements and a reasonable allowance for depreciation during the leasehold period.

Royalties, sale of patent rights.—Where a corporation assigns the right to manufacture articles under a patent which it owns, in consideration of the payment of a fixed sum for each article manufactured, the payments for the use of the patent are income to the corporation. The corporation will be allowed to deduct from gross income the depreciation in value of the patent.

Royalties from mines.—Where a lessor corporation has leased its mines on a royalty basis the royalty payments represent both income and a return of principal. The full amount of royalties received should be included as gross income, and an amount deducted which represents accurately the depletion of the mine.[1]

Income from interest.—All interest received, or accrued, if the books of the corporation are kept on an accrual basis, should be reported as income, with the exception of:

1. Interest on the obligations of a State or any political subdivision thereof.[2]

2. Interest upon the obligations of the United States or its possessions, with the exception of obligations of the United States issued after September 1, 1917.[2] Interest on United States Liberty Loan 3½s is therefore exempt, and need not be reported.

3. Securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916.[2]

Second Liberty Loan bonds.—Interest on bonds of the second Liberty Loan, i.e., first or second 4s, or on

[1] See Chapter on Corporation Deductions, p. 233, for a full treatment of depletion.

[2] See page 39, ante.

Treasury certificates of indebtedness, is, by the terms of the act authorizing their issue, entirely exempt from the corporation income tax, but is exempt from the excess profits tax only to the extent of the interest on $5,000 par value of bonds or certificates. As the amount of the excess profits tax is based upon the net income of the corporation as shown by its income tax return, the interest on bonds of the second Liberty Loan should be included as income from interest, and deducted at the end of the report, before computing the income tax.

For the purpose of enabling the Department to verify the returns, a supplemental statement giving the name of the obligation, the amount of principal, the rate of interest, and the amount of interest received is required of all tax exempt securities.

Accrued interest on bonds.—Income from bonds should include only the interest earned from the date of purchase. Where bonds are purchased between interest dates, the amount paid for the accrued interest should be deducted from the amount of interest received, and, conversely, when bonds are sold between interest dates, the amount received for the accrued interest should be reported as income.[1]

Amortization of premium or discount on bonds.—When bonds are purchased for more than their face value the amount of interest received is not the true income from the investment. To illustrate: a 6 per cent bond having one year to run is purchased for $1,030. The amount of interest received is $60. This is not the true income from the bond, as at the end of the year the holder receives only $1,000, a loss of $30. The true income is $30, or slightly less than 3 per cent on the investment.

Where the bond has several years to run the interest return should be adjusted by writing off, or amortizing, as it is technically called, the premium over the life of

[1] For illustration, see page 68, ante.

the bond so that at maturity the book value of the bond will be the same as its face value. A rough method is to divide the premium by the number of years the bond has to run and deduct the resulting amount from the book value of the bond and from the interest received each year. A more exact method, such as is used by insurance companies and other large investors, is described in Sprague's "Accountancy of Investment."

When the bonds are purchased at a discount, that is, for less than their face value, the circumstances are reversed. The true income is more than the interest received, because at maturity there is received a greater amount than the cost of the bond. The book value should therefore be written up or increased so that it agrees with the face value of the bond at maturity.[1]

These increases or decreases in the value of bonds as they approach maturity are reflected in their market value. Consequently, if a corporation is permitted to inventory its securities at market value when the market value is less than cost it cannot, in the case of bonds purchased at a premium, amortize the reduced value of the bond, as the market value itself reflects the decrease in value due to approaching maturity.

Interest on sinking fund.—Corporations often set aside, under the control of trustees, a sinking fund to meet their bonds as they mature. The trustees are usually permitted to invest this fund in the bonds of the corporation itself or in bonds of other corporations. The interest on the investments made by the trustees is considered taxable income in the hands of the corporation.

Where the fund has been invested in its own bonds a peculiar situation arises. The corporation pays itself interest, but may be prevented from deducting as an expense the interest it pays to itself, owing to the limitation on the amount of interest which may be deducted

[1] For illustration, see page 69, ante.

(see chapter on Corporation Income Deductions, page 243) and yet be required to include the interest as income.

It seems to the author that the only fair thing to do would be to exclude such interest both from the income side and from the deduction side of the report, but this view is not taken by the Treasury Department. The difficulty may be overcome and an equitable adjustment by the turning in by the trustees of the bonds purchased, so that they may be cancelled by the corporation. There is then no occasion for the corporation to pay itself interest.

DIVIDENDS RECEIVED

Income from dividends.—All dividends received should be included as income, regardless of the fact that the corporation declaring the dividend has been taxed on its net income.

Dividends, however, are subject only to the 2 per cent tax imposed by the act of September 8, 1916, and not to the additional tax of 4 per cent imposed by the act of October 3, 1917. The entire amount of dividends should be included as gross income, the adjustment being made in the calculation of the tax. Inasmuch as the earnings, from which these dividends have been paid, have already been subjected to a 2 per cent tax, the payment of the 2 per cent tax by the recipient of the dividend results in double taxation to that extent.

No dividends paid out of earnings or profits accumulated prior to March 1, 1913, are taxable as income in the hands of the recipient. This exemption applies only to dividends received subsequent to January 1, 1916, as the law of October 3, 1913, which was in force until that date, did not contain any exemption for dividends paid out of earnings accumulated prior to March 1, 1913.

The action of the Treasury Deparment in taxing such

dividends during the years 1913, 1914 and 1915 was upheld by the United States Circuit Court of Appeals, in *Lewellyn vs. Gulf Oil Corporation* (decided October 19, 1917).[1]

The rules for determining in what year or years the surplus distributed by a dividend was earned, apply equally to corporations and to individuals. The rules may be summarized as follows:

Dividends paid between Jan. 1, 1917, and August 5, 1917.—Any dividends paid in 1917 prior to August 6th may be declared by the paying corporation to be out of surplus accumulated prior to March 1, 1913. If not so declared they will be treated as being paid out of the most recently accumulated surplus.

Dividends paid on and after August 6, 1917.—All dividends paid on and after August 6, 1917, will be treated as having been paid out of the most recently accumulated surplus.

Dividends are taxable at the rates in effect for the year in which the surplus out of which they are declared was earned. Although corporations have been taxed on the basis of their net income since January 1, 1909, the income subject to tax in the period from January 1, 1909 to January 1, 1913, did not include any income from dividends; therefore, corporations have been taxed on dividends received only since January 1, 1913. And any dividends declared out of earnings accumulated prior to March 1, 1913, would not be taxable even though the specific exemption were not in the 1909 law.

In considering the rates of tax on dividends received by a corporation we must consider three periods:

Prior to March 1, 1913 ....no tax
March 1, 1913 to December 31, 1915..1 per cent
January 1, 1916 to date ....2 per cent

[1] For the possible effect of this decision, as to stock dividends, see Chapter on Income from Dividends, Individuals, pp. 87-98.

Where a rate of tax other than that in effect at the time of making the return is used, a statement should be attached to the return showing all the facts necessary to support the use of the lower rate.

Dividends received out of earnings prior to March 1, 1913, need not be included as income, but mention should be made on the return of the fact that they have been received and the reason for not including them should be given.

Dividends of Federal reserve banks.—Dividends on the stock of Federal reserve banks are exempt. It is held that the exemption provided for in the Federal Reserve act follows the dividend into the hands of the member banks holding the Federal Reserve bank stock.

Profits of subsidiary companies considered dividends to parent company.—The Treasury Department holds (T. D. 2137), that "in a case wherein a holding company actually takes up each month on its books its proportionate share of the earnings of the underlying companies, such holding company will be required to include in its gross income the amounts thus taken up regardless of the fact that the same may not have been actually paid to it in cash. The fact that the underlying companies credit to the holding company the amount of earnings to which it is entitled on the basis of the stock it holds, together with the fact that the holding company takes up on its books the amount thus credited, renders it incumbent upon the holding company to return these amounts as income, regardless of the fact that the underlying companies needed these earnings and used them in making extensions and improvements and in furtherance of their business."

The author does not see how this Treasury decision can be reconciled with the Department's attitude that unrealized or book profits are not to be considered income, or with the decision of the United States District Court in *Southern Pacific Company vs. Lowe,* in

which Judge Manton stated that "although the Southern Pacific held all the stock of the subsidiary and had actual possession of the moneys, it did not become legally entitled to the earnings of the subsidiary until such dividends were declared by the subsidiary."[1]

SPECIAL SOURCES OF INCOME

Gross income—other sources.—Income not covered under any of the headings already discussed should be included as income from other sources. Each item should be listed separately, with the source and the amount of the income.

Recoveries on bad debts.—Money received on accounts previously charged off as bad debts should be reported as income regardless of the date when such accounts were charged off.

Assessment paid by stockholders not income to corporation.—Assessments made against the stockholders of the corporation are considered payments on account of the capital stock issued and are not considered as income. Likewise, voluntary assessments paid by the stockholders are considered as additional payment for the capital stock, and not as income.

Corporation's compromise of indebtedness.—In a case where a creditor legally releases a debtor corporation from part of a debt, the amount of such debt released constitutes income, because the liability of the corporation is reduced and the net worth has correspondingly increased.

Reducing of bonded indebtedness.—Where a corporation in a reorganization takes over its own bonds in exchange for other securities and cash at less than the face value of the bonds, the difference between the

[1] In view of this decision of the court, it appears that such corporations should report as income from dividends only the income or earnings of the subsidiary which have actually been declared as dividends and as such paid over to the holding company.

value at which the bonds were taken up by the corporation and their face value would be income. This income should be prorated as between the period prior to March 1, 1913 and the period subsequent to that date, on the basis of the number of years the bonds had run. That part which was apportioned to the period subsequent to March 1, 1913, would be income for the year in which the bonds were redeemed, and taxable at the rate in effect for the year.[1]

Sale by corporation of its assets in consideration of stocks or bonds of the purchasing corporation.—The profit, if any, realized by a corporation in the sale of its assets to another corporation in consideration of stocks or bonds of the purchasing corporation, would be the amount received from the purchasing corporation which is in excess of the sum of the fair market price or value on March 1, 1913, of that part of the assets that were owned on March 1, 1913 and the cost price of that part of the sold assets acquired since March 1, 1913. In the absence of a definitely known or established market price of the value of the assets of the selling corporation, as of March 1, 1913, it should ascertain as nearly as possible, what the value of the assets was as of that date, taking into consideration, in addition to its capital invested, surplus and undivided profits, and the value of any of its intangible assets. The difference between the

[1] In cases similar to the above the Treasury Department has sometimes ruled that the dividing date between taxable and non-taxable income is January 1, 1909, the effective date of the Corporation Excise Tax. The act of August 5, 1909, imposed a tax on the net income of corporations for the calendar years 1909 to 1912 inclusive. This tax, even though based on net income was not an income tax. It was a tax levied on the franchise of the corporation for the privilege of doing business and the net income of the corporation was used as the measure of the value of the franchise. Having paid this franchise tax the corporation should not be compelled to pay an additional tax on account of income received in subsequent years, but which is held to have been earned in the period covered by the franchise tax. The division suggested in the text above is therefore correct.

sum of the fair market value and the price so determined, and the par value of the stock and bonds of the purchasing corporation, which will be assumed in the absence of any proof to the contrary to be worth par, will, for income tax purposes, be returned as taxable income.

The following case will serve to illustrate the above rule:

Corporation A

Assets sold, which were owned on March 1, 1913: market value of such assets as of March 1, 1913	$100,000
*Assets sold, which were acquired since March 1, 1913: cost price of such assets at time of purchase by Corporation *A*	200,000
Total sum of above	$300,000
Stocks and bonds of purchasing corporation received by Corporation *A* in payment of above property	$350,000
Profit of Corporation *A* (the selling corporation	$50,000

Sales of bonds at a premium.—When a corporation issues its bonds for more than their face value a book profit results. This apparent profit is really a present receipt of money by the corporation, for its agreement to pay a larger rate of interest in future years. The corporation could have sold bonds, bearing interest at a lower rate, at par and saved the larger interest payments in future years. This advance payment for interest, or the premium, should not be included in full as income for the year in which it was received, but should be distributed over the life of the bonds. The same

* In the above assets there should not be included any mere book appreciation of assets acquired either subsequent or prior to March 1, 1913.

rule applies to discount on bonds. The amount of discount should not be deducted in one lump sum but should be spread over the life of the bond.

Proceeds of life insurance.—When the corporation pays premiums on insurance policies, which are made payable to the corporation, upon the lives of officers or others, the proceeds of the policies, less the premiums paid (excluding such premiums as may have been previously been deducted),[1] must be reported by the corporation as income for the year in which the proceeds were received. It makes no difference whether the proceeds are received at the end of a specified time, as in an endowment policy, or upon the death of the insured.

Apparently the reason for this rule is to prevent a corporation from paying out large amounts in insurance premiums, in years when taxes are high, to obtain the return of the premiums (in the form of the principal of the policies) upon the death of the persons insured or at specified future dates in years when taxes may be low.

This reason, however, does not apply to premiums paid on time policies on lives of officers or employees. In this case there is no assurance that the corporation will ever obtain a return of premiums paid, for there is only a mere possibility of the officers or employees dying during the term of a time policy. While there has been no Treasury Department ruling on this point, it would seem that premiums paid on time policies are deductible. Such premiums are undoubtedly a necessary expense of the business, for they protect the busi-

[1] The old ruling of the Department was that premiums paid were deductible as an expense and that maturing policies should be returned as income in full. Under the new regulations, as stated above, premiums paid are not deductible as an expense but are allowed as a credit towards the amount received at maturity of the policy.

Premiums previously deducted as an expense should not again be deducted at the maturity of the policy.

ness against sudden losses that the business might sustain through the death of an individual officer. In some cases the success of the business depends on the activity of one individual, and insurance on his life is almost an indispensable expense. In the case of these "one man" concerns, some of its creditors refuse to extend credit to it unless insurance is carried in the life of that man, and moreover the carrying of business life insurance strengthens the credit standing of the concern in many cases as much as does the carrying of fire insurance. For these reasons, premiums paid on time policies on the lives of employees or officers of a corporation, where the loss is payable to the employer, should be an allowable deduction from income.

Appreciation in value of capital assets.—Appreciation in the value of capital assets, even though evidenced by an entry upon the books of the corporation, is not income until the appreciation has been converted into cash or its equivalent. It is, therefore, unnecessary to report any such appreciation until the property is sold.

On the other hand, no decreases in value, excepting allowances for depreciation and depletion, may be deducted until the loss, as the result of a closed transaction, has been definitely ascertained.

Appreciation of good-will.—A surplus created by placing good-will upon the books of a corporation or increasing the value of the good-will already on the books is not taxable income.

Sale of capital assets.—The profit resulting from the sale of a capital asset is the difference between its cost, if it was purchased subsequent to March 1, 1913, or the market value as of March 1, 1913, if purchased prior to that date, and the selling price when the selling price is greater than the cost.

The market value as of March 1, 1913, may be established in any manner which results in the determining of a "fair market price."

In the case of securities listed on an exchange, the *average* quotations for March 1, 1913, would be accepted as the "fair market price."

In the case of real estate, an appraisal made within a reasonable time of March 1, 1913, would be acceptable.

The assessed value of real estate may be used, but where the average assessed value of property in the district does not represent the market value, an adjustment should be made. To illustrate, a piece of real estate was assessed in October, 1912, at $60,000. In January, 1913, a piece of property in the same district, assessed at $12,000, was sold for $20,000, and another plot assessed at $18,000 was sold for $30,000. These two sales would indicate that property in the district was assessed at about 60 per cent of its market value. The market value in October, 1912, of the property which was assessed at $60,000 would be $100,000, which figure could be used as the fair market value on March 1, 1913.

If it is not practicable otherwise to establish the market price on March 1, 1913, the apportionment of the entire sum, i.e., the difference between cost and selling price, over the period the asset was owned would help determine the "fair market price" as of March 1, 1913. To illustrate: *A* purchases property March 1, 1910, for $5,000 and sells the property March 1, 1917, for $19,000. If there is no other practicable means of determining the value as of March 1, 1913, the gain of $14,000 may be apportioned over the entire period the property was owned. Thus, three-sevenths of the increment, or $6,000, would be regarded as having accrued prior to March 1, 1913, and four-sevenths, or $8,000, since that date. This would tend to show that the value on March 1, 1913, was $11,000, and that only $8,000 of the gain is taxable. Of course, if any of the other methods mentioned above could be used, this method would not be permitted.

In all cases, a statement should be attached to the

return showing how the fair value as of March 1, 1913, was determined.

The use of the market value of March 1, 1913, works a hardship in cases where that value is less than the original cost. To illustrate: a piece of real estate is purchased in 1909 for $50,000. The market value March 1, 1913, is $35,000. In April, 1917, it is sold for $45,000. The difference between $45,000 and $35,000, or $10,000, must be reported as income for 1917. As a matter of fact, the net loss on the transaction is $5,000, but the corporation is not allowed any credit for the loss in the period from 1909 to March 1, 1913. The Department is justified in its attitude, on the ground that the tax for the period from January 1, 1909, to March 1, 1913, was not an income tax, and that the Income Tax law levies a tax upon all income and profits earned or accrued since March 1, 1913, and that the difference between the value as of March 1, 1913, and the selling price is the measure of such profit as provided by the law.

Where real estate is purchased subsequent to March 1, 1913, there may be added to the original cost all special assessments paid for local benefits in connection with the property, and such carrying charges as have not been deducted in a report of net income made in the year in which it was purchased or in subsequent years.

Property purchased for capital stock.—In cases where property is taken over in exchange for capital stock of the corporation at a par value greatly in excess of the true value of the property, the transaction may be ignored as establishing the cost of the property, and the actual value of the property at the time of acquisition may be considered as its cost.

The same rule may be followed where the property is taken over at a nominal figure. The true value of the property at the time of its acquisition may be consid-

ered as the cost, and the difference between this figure and the selling price reported as profit.

In all such cases the value placed upon the property is subject to the approval of the Bureau of Internal Revenue, and in making the return a statement should be attached showing the amount paid for the property, and the method used in arriving at the true value.

Other forms of income.—The calculation of income from stock transactions and other transactions is discussed at length under the "Individual Return" on pages 59-66.

CHAPTER IX

INCOME TAX ON CORPORATIONS

DEDUCTIONS

Deductions from gross income.—A payment of cash or its equivalent made by a corporation results in either (1) an increase in some asset (or, what is practically the same, a decrease in liabilities), or (2) a decrease of the income for the period. Expenses may be divided therefore into capital expenses and income expenses. Capital expenses add to the value of some asset and are not deductible from gross income. Income expenses are those expenses which are incurred in connection with the earning of the gross income and which are a proper deduction in determining net income.

The Income Tax law recognizes this distinction between charges against capital and charges against income and does not permit the deduction of any capital expenditures. The law also places some arbitrary limits upon the deduction of certain items of expense, which are considered by business men as ordinary expenses of the business. These will be referred to later.

The deductions allowed by the law may be divided into four classes: ordinary and necessary expenses of business; losses, including depreciation and depletion; interest paid; and taxes. These will be discussed in the order mentioned.

ORDINARY AND NECESSARY EXPENSES OF THE BUSINESS

Ordinary and necessary expenses of the business.—The Income Tax law, sec. 12, subdivision (a), provides for the deduction of:

"All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity."

Cash or accrued expenses.—The law provides for the deduction only of such expenses as are paid within the year. But, inasmuch as the law permits the keeping of accounts on some other than a cash basis, any expense charged upon the books may be deducted, even though it has not been paid, provided the gross income of the corporation is reported in the same manner. Such accrual items should not again be deducted when they are paid, nor should any item of expense be deducted here, if it has been included elsewhere as cost of merchandise and credited against gross income.

Prepaid expenses.—Where accounts are kept on a cash basis all expenses paid during the year, whether for the present, a past or a future period, should be deducted. Where accounts are kept on an accrual basis, only such expenses as are applicable to the period for which the income tax report is rendered should be deducted. Therefore, if insurance premiums are paid for a policy for two years, only that part of the premiums representing amounts paid for protection during the present period should be deducted.

The same rule applies to prepayment of taxes. Only so much of the taxes as are for the present period should be deducted. Taxes paid in the present period for future periods should be carried on the books as a deferred asset, and charged off as expense in the future periods.

Payments in advance for contracts to be completed over a period of years, and all other prepaid expenses, should be treated in the same way.

Payments of expenses need not be in cash.—The payments for expenses need not be made in cash. They may be made in merchandise, stock, or any other asset. In this case, the actual value of the asset may be deducted as an expense. For example, the value of stock paid to officers as salary would be a deductible expense.

Capital stock paid for a contract.—The value of capital stock of a corporation that is given in consideration of a contract is a deductible expense of the corporation giving the stock, but the expense should be prorated over the life of the contract, either on a per year basis or on a per unit basis. Thus, if a corporation gives $1,000 worth of stock for a contract that will run over a period of five years, the corporation may deduct as an expense $200 during each of the five years. This $200 represents the amount paid in advance for one year of the contract. If the contract is to produce a certain number of units, even though the contract will run over a definite period of years, it would be better and more scientific to deduct each year that part of the cost of the contract represented by the ratio of the value of units manufactured to value of the total units to be produced under the contract. Thus, if a corporation pays $1,000 worth of stock for a contract calling for the manufacture of 10,000 rifles at $100 each, in five years; 4,000 to be manufactured the first year, 3,000 the second, and 1,000 the third, fourth and fifth years, the corporation should deduct as an expense of obtaining the contract $400 the first year, $300 the second, and $100 the third, fourth and fifth years.

The value of the stock should be determined by ascertaining what was the actual value at the time of the transfer of the stock, or what amount it could have been sold for in cash or its equivalent at the time of delivery.

Salaries, wages and commissions.—All payments for salaries of employees, wages and commissions should be

deducted. Salaries of officers of the corporation should be shown under a separate caption irrespective of the amount so paid. The salary or commission may be paid in stock of the corporation, in which case the deduction would be the actual value of the stock so given, provided such amount was charged as an expense on the books of the corporation at the actual value of such stock.

Salary to be deducted must be actually entered upon the books as an expense of business, and if the corporation renders its return of income upon the *cash* basis such salary, to constitute a proper deduction, must not only be entered upon the books of the corporation as an expense but must also be actually paid in cash to the recipient. But if the corporation renders its returns on the accrual basis, the corporation would include as an expense the amount representing the salary accrued. Even in this latter case, if the individual made his report on a cash basis, he would report the salary as income only in the year in which it was actually paid to him by the corporation.

Salaries of officers and employees who are stockholders of the corporation.—Salaries of officers or employees, who are stockholders or who have an interest in the business, will be subject to careful analysis, and if they are found to be rather in proportion to the stock holdings or interest of such officers and employees than to the real value of the services rendered, and to be in excess of the salaries paid to officers or employees in similar positions in other concerns doing business of a like nature and of approximately equal volume and earnings, the amount paid in excess of reasonable compensation for the services will not be deductible from gross income, but will be treated as a distribution of profits. (T. D. 2616.)

Where any payment to an officer or other stockholder of a corporation is held by the Treasury Department

to be a distribution of profits, such payment should be treated by the individual receiving it as a *dividend* from the corporation.

The author is aware of a number of cases where an additional tax has been assessed against a corporation on the ground that certain payments to its officers were a distribution of profits and not compensation for services, in which cases adjustment was then made on the individual returns of the officers to reflect such income as a dividend, which in fact it was.

Salaries of soldiers.—Where a corporation continues to pay an employee his salary during his service in the United States Army, it will be considered a necessary expense of the operation of the business and may be deducted.

Pensions.—Amounts paid for pensions to retired employees or those dependent upon them for support, including their families, or pensions paid on account of injuries received by employees, are proper deductions as ordinary and necessary expenses of the business.

A monthly salary paid to the widow of a former employee for a limited period in recognition of the services of the deceased husband, no services being rendered by the widow, is held to be a gratuity and is not an allowable deduction from gross income.

Gifts, gratuities and bonuses.—As gifts received by an individual are not taxable, the corporation making the gift is not allowed to deduct gifts to its employees. Gifts to customers, such as souvenirs, would be considered a necessary expense of advertising the business, and allowed as a deduction.

The attitude of various internal revenue officers on the question of bonuses varies greatly, because of the latitude allowed them by the regulations contained in Letter 1314 to collectors, which reads as follows:

"Special payments made by a corporation as extra compensation to certain of its employees, may be de-

ducted from gross income if it is clearly shown that such payments are made as compensation for services rendered, and paid in pursuance of a contract express or implied. But if there is no contractual relation between the employer and the employees by which the employee could enforce his claim for additional compensation, the payments would be considered as payments of gratuities and as such are not an allowable deduction."

This ruling, which made every corporation act as a judge in determining whether or not a contract existed between itself and employees, has been modified by T. D. 2616, which reads as follows:

"In order to establish uniformity and to facilitate the work of internal revenue officers who are engaged in the examination of books for the verification of returns of annual net income made pursuant to the requirements of the Federal Income Tax Law, you are informed that special payments, sometimes denominated gifts or bonuses, made by corporations, partnerships, or individuals to officers or employees, will constitute allowable deductions from gross income in ascertaining net income for the purpose of the income tax, when such payments are made in good faith and as additional compensation for the services actually rendered by the officers or employees. If such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered, they will be regarded as a part of the wage or hire of the officer or employee, and therefore an ordinary and necessary expense of operation and maintenance, and as such will be deductible from gross income."

Campaign contributions and lobbying expenses.—The Income Tax law provides for the deduction only of ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties." Sums of money expended for lobbying

purposes and contributions for campaign expenses are held not to be an ordinary and necessary expense in the operation and maintenance of the business of a corporation and are therefore not deductible.

Donations must represent consideration of value.—Donations by corporations which legitimately represent a consideration for a benefit flowing directly or indirectly to the corporation as an incident of its business are allowable deductions. This would include, for example, donations to a hospital upon consideration that employees of the corporation are to have a ward for their use in case of accident or illness. The absence of consideration moving in some form to the corporation will make the contribution a mere gratuity, which would not be deductible.

Donations for obtaining good-will.—A corporation engaged in agricultural business is not allowed to make a deduction on account of donations to fairs, churches, and associations, when such donations are made for the purpose of obtaining and holding the good-will of the farmers who raise crops for it, since the amounts so expended are clearly in the nature of gratuities and are not necessary expenses of operation and maintenance.

Salesmen's spending or treating money. — The so-called spending or treating money actually advanced by corporations to their traveling salesmen as a part of the selling expense of the product of such corporations is an allowable deduction in a return of income by such corporation. There must be some evidence shown that all the allowance claimed as a deduction was actually expended for the specified purpose, namely, the selling of the product of the corporation in question.

Donations and gifts.—A glance at the above decisions will show that the main purpose is to make a sharp distinction between gratuities, or payments from which no benefit accrues to the corporation, and expenses

which result directly or indirectly in a benefit to the corporation. To make this distinction is, in some cases, rather difficult. A cash donation to a church fair is, in the author's opinion, no less an expense than an advertisement in the program for such fair. There are certain contributions to local activities which must be made by a corporation in order to keep the good-will of the public. These donations are a form of advertising and should be allowable as necessary expenses of the business. Opposed to these petty gratuities we have contributions which do not add to the good-will of the corporation and which are not necessary to the operation of its business. The word "necessary" may be variously interpreted, and it is impossible to write a definition that will be equitable in every case. The tendency which in the past was very common in close corporations to charge personal donations as expenses of the corporation will be lessened, because of the amendment in the law permitting individuals to deduct contributions made to religious, charitable and educational organizations up to 15 per cent of the individual's net taxable income.

Ordinary and incidental repairs.—Under this caption should be reported all expenditures for incidental repairs which neither add to the value of the property nor appreciably prolong its life, but which keep it in an operating condition.

Expenditures for new buildings, permanent improvements or betterments which increase the value of property, or for restoring or replacing property, are not deductible under this or any other item of return. Such expenditures are chargeable to capital accounts.

Premiums on life insurance.—A corporation is not permitted to deduct from income the premium paid on life insurance policies covering the lives of officers, employees or those financially interested in the trade or business. However, the total amount of the annual

premiums paid may be deducted from the gross proceeds of any policies of which the corporation is beneficiary, when such proceeds are received.[1]

Depositors' guaranty fund.—Banking corporations which are required by State laws to make contributions to a "Depositors' Guaranty Fund" may deduct the full amount levied against them. This amount may be deducted even though it is not paid out, but simply carried on the books as a credit to the State banking board.

Organization expenses.—The attitude of the accountant with regard to organization expenses of a corporation is that such expenses do not create an asset which has any tangible or residual value, and that they should be charged off over as short a period as possible. The position of the Treasury Department as stated in T. D. 2499 is that such expenses are a capital item and are not deductible in computing net income subject to the tax.

The text of this decision, with the arguments of the Government in support of its position, is as follows:

Numerous inquiries have been made to this office with respect to the treatment by corporations in their returns of annual net income of what are commonly known and designated as "organization expenses"—that is, attorneys' and accountants' fees, together with fees paid to the state authorities prior to, or coincident with, the securing of a charter and the incorporation of the company.

In the absence of a formal and definite ruling on this question, there appears to have been some conflict in the holdings and instructions issued by this office in regard to this matter. Therefore, in order to make definite the position of the bureau and to promote consistency, it is held that "organization expenses" constitute a capital investment, such expenses being offset by the asset value of the corporate franchise, an intangible asset of a somewhat permanent character and in many instances of substantial value. Such expenses are very similar in character to the discount at which the stock issued by a corporation is being sold, the only effect of such expenses and discounts being to reduce the amount of capital available for use and employment of the business of the corporation. The discount at which the stock is sold is not a loss sustained within the meaning of the law, and therefore is not deductible. Likewise, "organization expenses"—that is to say, expenses incident to and connected with the incorporation and organization of the company—are not "ordinary

[1] See chapter on Corporation Income, page 200.

and necessary expenses of maintenance and operation," which are the only "expenses" authorized by the Income Tax law to be deducted from gross income.

Hence it is held that "organization expenses" do not constitute an allowable deduction from the gross income of any taxable year, nor do such expenses constitute a proper item to be added to the cost of any physical property to be provided for through the authorized annual allowance for depreciation.

The question naturally arises as to whether this decision, which was published June 11, 1917, has any effect on returns for 1916 or previous years. Many corporations have deducted their organization expenses in previous returns, under the prevailing impression that they were legitimate deductions. Are such corporations subject to an additional assessment?

It must be remembered that the Treasury Decisions do not change the law itself, but they do modify the interpretation of the law. The law cannot be held as meaning one thing for a certain period and the opposite for a latter period. Any Treasury Decision must therefore be effective as of the date of the law itself.

The Income Tax law provides that necessary expenses of business may be deducted. The Treasury Department in the above decision states that it does not consider organization expenses as necessary expenses of business. Therefore additional assessments may be levied against corporations for any tax due on the amount of organization expenses which were charged as an expense of business and deducted from gross income.

In some cases it will prove profitable for the corporation to reopen the matter of its own accord, and pay the additional tax. The advantage lies in the fact that the amount of organization expense would be considered as a capital asset, and might reduce the amount of excess profits tax more than enough to offset the extra income tax.

Rentals.—Payments for the use of property are required to be divided into two classes: ordinary rentals,

and payments in lieu of rent. Payments in lieu of rent include all royalties, interest payments and any other charges which the corporation is required to make for the right to use property in which it has no title, interest or equity.

Additions and betterments made by tenant.—Corporations occupying premises under a lease which requires them to make all necessary repairs or improvements, which revert to the owner at the expiration of the lease, are entitled to charge the cost of such repairs and improvements to the expense of business. The cost of those repairs or improvements that are somewhat permanent in character should be prorated over the number of years constituting the remaining term of the lease.

In the case of buildings erected upon leased ground the entire cost of the building should not be deducted in the year it is built. The cost should be prorated over the life of the lease, and the proportionate amount deducted each year.

Interest paid as rental.—Interest paid on the bonds of another corporation as a rental payment for the use of property held under a lease may be deducted by the lessee corporation as a payment in lieu of rent. But if the lessee corporation assumes the bonds of the lessor corporation, it may deduct such interest only if it does not exceed the limitation placed on the amount of interest which may be deducted.[1]

Payments in lieu of rent made by a lessee to bondholders and stockholders of the lessor corporation, representing interest on the outstanding bonds and dividends on the outstanding stock of the lessor, are allowable deductions as an item of rental when paid by the lessee for the use of the property of the lessor.

Public utility earnings payable to State, territory, etc.—When a public utility is constructed, operated or main-

[1] See page 243.

tained under contract with any State, territory or political subdivision and the public utility corporation under the contract with the State pays to it a certain portion of its net earnings, the amount so paid may be deduced as an expense of the business.

LOSSES, DEPRECIATION AND DEPLETION

Losses, depreciation and depletion.—The losses which may be deducted are divided into three classes. First, losses actually sustained and charged off; second, reasonable allowances for the wear and tear of property arising out of its use or employment in the business or trade; and third, a reasonable allowance for the depletion of mines and oil and gas wells.

Losses actually sustained and charged off within the year.—Losses to be deducted must both actually be sustained and be charged off on the books during the year in which the return is made, and these losses should be based upon the difference between the actual cost of the asset and any salvage value it may have, including in the latter value such amounts as have been previously set aside and deducted from gross income by way of depreciation. For illustration, *B* Corporation purchased in January, 1915, a machine for $10,000, and charged off as depreciation 10 per cent of the cost each year during the years 1915 and 1916. In January, 1917, a fire occurred and the machine was entirely destroyed and had no value except for scrap such scrap value being $100. No insurance was carried on the machine. The total loss was the difference between the cost, $10,000, and the sum of the amounts charged off as depreciation, $2,000 plus the scrap value, $100, or $7,900. This loss of $7,900 may be deducted.

The cost of any property acquired subsequent to March 1, 1913, should include its actual cost plus cost of improvements made thereto and any expense in-

curred incident to the procurement thereof. The cost of property acquired prior to March 1, 1913, would be the fair market price or value as of March 1, 1913, plus any improvements made subsequent to that date and any expense incurred in the sale thereof.

The loss must be the result of a closed transaction. Book entries reflecting a loss (as distinguished from entries recording depreciation) are not of themselves a proper ground for a deduction. This is more fully discussed in a later chapter on depreciation.

Losses incurred in the sale and retirement of bonds.—When a corporation sells its own bonds at a discount the amount of the discount should be prorated over the life of the bonds and the proportionate part of such discount applicable to each year during the life of the bonds should be deducted.

For example, let it be supposed that a corporation sells an issue of $1,000,000 twenty-year bonds at a discount of 10 per cent, or for $900,000. Each year the proportionate part of that discount, or $5,000, would be allowable as a deduction.

Very often a corporation is required, under the terms of an indenture securing the issue of bonds, to purchase and retire annually a certain number of its bonds. The corporation, to retire the annual amount, may be compelled to purchase in the open market and to pay more than par for the bonds; under the terms of the mortgage it may be compelled to reduce the bonds by lot or otherwise at a premium. In such cases the difference between the par value and the price at which they were purchased for retirement, is allowed as a deduction, provided the bonds were issued at par. When the bonds were issued at a premium and the premium was treated as income for the year in which issued, the difference between par and the purchase price may be deducted as a loss; but if the premium is being prorated over the life of the bond, the loss is

the difference between the price at which the bonds were issued, less such part of the premium as has been taken up as income, and the purchasing price. Where bonds were originally sold at less than par and the discount on the bonds has been prorated over the life of the bonds and charged off annually, the difference between the price at which the bonds were issued and the redemption price minus an allowance for the amount of discount that has already been charged off, may be deducted as a loss for the year in which the bonds are purchased for retirement.

Real estate losses.—A loss on a real estate transaction is the difference between the selling price and the cost if the purchase was made subsequent to March 1, 1913, or the difference between the selling price and the market value as of March 1, 1913, if the property was purchased prior to that date.

The methods to be used in determining the cost or market value of real estate are discussed on page 59.

Losses sustained in stock transactions.—The Income Tax law does not place the same restriction upon corporations as it does upon individuals as to the nature of deductible losses.

As previously explained, individuals are permitted to deduct *all* losses incurred *in trade,* but are permitted to deduct losses incurred in transactions *not in trade,* but which are entered into for profit, *only* to the extent that profits from similar transactions are reported as income.

The act of September 8, 1916, as amended, does not impose this restriction upon corporations, but permits the deduction of: "All losses actually sustained and charged off within the year and not compensated by insurance or otherwise."

It therefore follows that *any* loss actually sustained by a corporation, even through speculation in stock or on margin, which is properly reflected in its books of

accounts, will constitute a proper deduction from gross income of the year in which the loss is definitely determined. The charter of a corporation often permits of operations beyond the primary purposes for which it was organized, and the Treasury Department has held that any loss actually sustained and properly deductible, under the regulations for such deductible losses, i.e., actually sustained and charged off, will constitute a proper deduction from gross income in the year in which the loss is so determined.

Bad debts.—The deductions for bad debts allowed to a corporation are subject to the same restrictions as are the deductions allowed to an individual.[1] The debt must be definitely ascertained to be uncollectible. It is not necessary that the debtor be adjudged a bankrupt, in order that the debt may be deducted as a loss. The amount of the claim, the time the debt has overrun, and the financial condition of the debtor may render it inadvisable to attempt to collect the item by suit.

Inasmuch as the item of "losses charged off" is one which the taxpayer is frequently called upon to substantiate, every corporation should be prepared to support this item of deduction either by a notice of the debtor's discharge in bankruptcy or by correspondence showing a reasonable ground for charging off the accounts as uncollectible. If at any subsequent period the debt is collected, the sum so collected must be included as income.

Reserves for bad debts or other losses.—Reserves created to provide for bad debts which might prove uncollectible in the future are not a proper deduction for the purpose of the income tax. The same rule applies to reserves for discounts on outstanding accounts receivable, reserves for contingencies or similar anticipations of losses which have not been, and may never be, charged off or actually sustained.

[1] See page 122.

But insurance premiums, including credit insurance premiums, *paid* for protection against the above losses, may be deducted.

Depreciation.—A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade is an allowable deduction.

It is important to distinguish between fluctuation and depreciation. The former is a change in the market value of the assets, either favorable or unfavorable, which is due to causes apart from the business. These fluctuations, as we have already stated, should not be taken into consideration in determining the net income until the profit or loss has been definitely determined as the result of a closed transaction.

Depreciation, on the other hand, is a decline in the value of property as a result of wear and tear. It is due to the possession and use of the assets and is therefore a proper deduction from the income produced by the assets.

Repairs and renewals.—In *Cumberland Telephone and Telegraph Co. vs. City of Louisville* (187 Fed. Rep., 637) the court defined depreciation as "the loss in value of some destructible property over and above current repairs." The distinction between repairs and depreciation is sometimes difficult for the layman to appreciate, but to get a grasp of the subject, the distinction must be understood thoroughly.

An understanding can perhaps best be given by using an imaginary concrete example. A company may have a gross income of $100,000 and spend, besides $50,000 for producing, selling and administrative expenses, $1,000 for repairs of its property. Its total money spent for operations, therefore, would be $51,000. But this does not represent the total cost of earning the $100,000 of gross income. This total cost should cover loss of value of the plant not included in the $1,000

actually paid out for repairs. The income, therefore, should be charged with this amount of loss, and the same amount credited to an appropriate reserve account. From year to year the *ordinary* repairs required to keep the property in normal working condition should be charged to income, that is, deducted in arriving at the amount of taxable net income. But, besides ordinary repairs, there should also be deducted the amount credited to the depreciation reserve.

Suppose, now, in some year, it is decided to overhaul the property generally and to do more than is just necessary to keep the property in good efficient operating condition. This may cost $5,000. Since $4,000 of this is spent to conserve the life of the asset, and since this is the very reason why the income was charged with income that was not spent, this $4,000 will not be a proper charge to the income of the year in question. It will be charged to the reserve. In other words, the company will now merely be spending the amounts deducted from income of the previous years though not spent in those years. In short, the $4,000 representing extraordinary work for maintaining the life of the property could not be deducted as an expense in arriving at the taxable amount of net income.

The distinction between repairs which do not prolong the life of an asset, and renewals which offset the depreciation that has already occurred, is brought out in the following extract from a letter from former Commissioner of Internal Revenue Osborn to the Corporation Trust Co.:

"This office recognizes the fact that a building or a piece of machinery or other equipment as a whole may deteriorate in value and usefulness by reason of wear and tear, regardless of the fact that certain minor component parts may be renewed, restored and replaced. The depreciation deduction authorized by the law, therefore, contemplates the creation of a fund that will renew, restore, or replace the original property when it has become worn out or exhausted, regardless of the renewal and restoration of parts that may have been made in the meantime. Hence it is held that in addition to the depreciation intended to cover the cost of the property as

a whole, the expense of incidental repairs which do not add to the cost of the property but merely keep it in an operating condition, may be allowably deducted from gross income as an expense of operation or maintenance.

"It is barely possible in some instances that worn out parts of a machine or similar equipment may be renewed one after another until the original machine or equipment is swallowed up in the renewed parts and the machine or equipment is then in as good operating condition as it originally was. In this case, if the cost of renewal parts is charged to operating expense, no deduction on account of depreciation should be claimed or allowed as to such machine or equipment.

"This would appear to be true in the case of pipe lines, worn out pipe covering and similar articles of equipment. By replacing one joint of pipe after another, all may be replaced, and if the expense is deducted as an operating expense, any depreciation fund that may have been reserved for the purpose of restoring the pipe line as a whole, will remain unused.

"So that in cases of this kind, if a depreciation reserve is set up to cover property that may be renewed or restored, part by part, until the whole is renewed, the cost of the renewed parts should be charged to the depreciation reserve fund and will not be considered incidental expenses within the meaning of the regulations hereinbefore referred to."

The rate of depreciation.—Neither the Income Tax law nor any regulations of the Treasury Department provide for any definite rates at which the allowance for depreciation should be calculated. The only restriction is that the allowance deducted should represent as nearly as possible the loss in value of the property.

The basis on which the depreciation is to be calculated depends upon three factors—the cost of the asset, the life of the asset, and the residual value of the asset.

The residual value.—Most assets, whatever their life may be, have a scrap or residual value. No machine is absolutely worthless, even if it has to be sold for old iron. This residual value should be estimated as accurately as possible. The total amount to be charged off should be ascertained by deducting the residual value from the original cost.

The cost of the asset.—Inasmuch as the allowance for depreciation is to provide for the replacement of the asset when it is worn out, the total amount of depreciation to be deducted would be limited to the cost of the asset, less its residual value. Where the book value of

the asset has been written up or increased, the depreciation may be taken only upon the original cost of the asset, and not upon the book value, inasmuch as profits caused by revaluation of assets are not taxable income; such revaluation figures would be allowable as a basis from which to estimate depreciation only in case the increase in book value of the asset has been included as income and the tax paid on such income at the time of the revaluation.

The life of the asset.—The final factor in determining the amount of annual depreciation is the life of the asset. It is impossible to establish, with any degree of accuracy, a uniform statement of the life of various classes of assets. The factors affecting the life of an asset are many, including the use to which it has been put, the care taken of the asset, and the extent to which it has been kept in repair. The deduction allowed by the Income Tax law does not include any provision for obsolescence, but should the property become obsolete or worthless before its estimated probable life has expired, a deduction representing the difference between the cost of the property and the amount previously charged off for depreciation may be deducted as a loss, the amount in question being due to the obsolescence of the property.

The loss due to obsolescence of the property is separate from the depreciation caused by the wear and tear on the property as a result of its use in business, and is deductible only when such obsolescence has actually occurred. It is not necessary that the property be actually sold in order to establish the fact of obsolescence.

A clear statement of the factors to be considered in estimating the life of a building is contained in the decision in *Cohen vs. Lowe* (234 Fed., 474). The opinion of the court was as follows:

"The plaintiff was allowed 3 per cent for depreciation on an apartment house owned by him. The burden is on him to show that depreciation so

allowed was too small. This allowance is for the wear and tear suffered by the building during the tax year, which means the physical deterioration the building suffered during that period. It does not take into account depreciation in value due to a loss in rental value because of the construction of more modern buildings with improved facilities, or due to a change in the neighborhood. It is to be based upon the life of the building in the sense of the number of years the building would remain in a condition to be habitable for the use for which it was constructed and used, and which was in the present case for an apartment house, and not merely the number of years it would stand without being condemned and torn down."

The Treasury Department has consistently refused to commit itself to any fixed rates of depreciation on any class of property, inasmuch as depreciation on a certain class of assets in a particular line of business may not equal the depreciation on a similar class of assets in a different line of business.

The following table of the estimated life of various classes of assets is not intended to be authoritative, but it will give a general idea of the rate of depreciation on the classes of property listed.

Asset	*Estimated life*
Brick Buildings	50-60 years
Frame Buildings	30-35 years
Brick Buildings—Heavy Machinery	25-35 years
Frame Buildings—Heavy Machinery	20-25 years
Machinery	8-20 years
Furniture and Fixtures	5-10 years
Wagons	10-15 years
Automobiles	5- 7 years

Land and buildings.—Land is not subject to any depreciation as a result of wear and tear, although land used for agricultural purposes is subject to a loss of fertility unless this is prevented by the use of fertilizers or proper rotation of crops, which loss is a form of depletion and should be shown under that particular heading. It is necessary, therefore, for the purpose of calculating depreciation, to separate the value of the

land from the value of the improvements. Unless the improvements were made by the corporation after it had purchased the land, it would be difficult to ascertain the cost of the building as distinguished from the land. Where the cost of the building cannot be ascertained, it is permissible to use an estimated value as of March 1, 1913.

Methods of calculating depreciation.—Having settled upon the factors affecting the amount of depreciation, namely, the cost, the life, and the residual value of the asset, the next step is to calculate the amount to be charged off each year. There are, generally speaking, six distinct methods of distributing the amount of the depreciation over the life of the asset, as follows: (1) the fixed percentage method, (2) the weighted year method, (3) declining balance unscientific, (4) declining balance scientific, (5) sinking fund, (6) periodical revaluation.

Fixed percentage method. — The simplest and most popular method is the "fixed percentage." The difference between the cost and residual value of the asset is divided by the estimated life of the asset, and the result is charged off. The effect is that an equal amount of depreciation is charged off each year. The argument against this method is that as an asset becomes older the cost of repairs necessary to keep it in proper condition increases, and since the income is charged with the amount of depreciation as well as with the cost of ordinary repairs, the charges against income are heaviest in the latter years of the life of the asset.

The weighted year method.—The weighted year method answers this objection by decreasing the amount of depreciation each year, thus equalizing the total charges of depreciation and repairs. The amount of depreciation may be determined for any year by multiplying the total depreciation by a fraction having the number of years the asset will still last as a numerator, and the sum of the total years of its life as a denomina-

tor.[1] To illustrate, an asset costs \$1,500, and has a life of 10 years and a residual value of \$400; the total depreciation is therefore \$1,100. Applying the weighted year method of calculating the depreciation for the first year, simply multiply the total depreciation, \$1,000, by the fraction referred to, i.e., $\frac{10}{55} \times \$1{,}100 = \$200$. The depreciation the second year is $\frac{9}{55} \times \$1{,}100$, or \$180. The depreciation the third year is $\frac{8}{55} \times \$1{,}100$, or \$160. The depreciation the tenth year is $\frac{1}{55} \times \$1{,}100$, or \$20.

The declining balance unscientific.—The declining balance unscientific method is, as its name implies "unscientific." Instead of deducting the same amount each year, as under the fixed percentage method, an arbitrary percentage is calculated on the declining value of the asset, as follows:

Cost of asset, \$1,000; life, 5 years; residual value, \$100.

Cost	\$1,000.00
Depreciation, 20 per cent	200.00
Value, end of first year	\$800.00
Depreciation, 20 per cent	160.00
Value, end of second year	\$640.00
Depreciation, 20 per cent	128.00
Value, end of third year	\$512.00
Depreciation, 20 per cent	102.40
Value, end of fourth year	\$409.60
Depreciation, 20 per cent	81.92
Value, end of fifth year	\$327.68
Residual value	100.00
Depreciation, not written off	\$227.68

[1] For example, if the life were 10 years, this sum would be the sum of 1+2+3+4+5+6+7+8+9+10=55. The formula for the sum of an arithmetic progression is $\frac{N\ (A \text{ plus } Z)}{2}$ where N is the number of terms and A is the first term and Z is the last term. The sum of the numbers from 1 to 10 would be $\frac{10\ (1 \text{ plus } 10)}{2} = \frac{110}{2} = 55$.

It will be seen that this method does not provide enough depreciation, and that an extra charge is necessary at the end of the last year. This method, it will be noticed, does not entail an estimate of the probable life of the asset.

The declining balance scientific.—The declining balance scientific method is similar to the unscientific, with the exception that the percentage is accurately calculated so as to take up the full amount of the depreciation.[1]

The sinking fund method.—The sinking fund method requires a fixed sum to be set aside annually which, with interest, will at the end of the life of the asset equal the total amount of depreciation. This method involves rather confusing interest adjustments and is seldom used.

Periodical revaluation.—The periodical revaluation of assets cannot be used to determine the amount of depreciation deductible for the income tax, as these valuations take into consideration changes in value due to causes other than wear and tear.

Amount of depreciation under each method. — The amounts of depreciation for each year under the various methods which have been described are shown by the chart on page 229.

Since the amount deducted for depreciation must be supported by a statement of the nature of the asset, its cost, its estimated life after purchase, and the amounts previously deducted for depreciation, it would be advisable, unless the fixed percentage method has been used, to attach a statement to the return, showing the method employed.

[1] The formula for finding the required percentage to reduce original value "V" to salvage value S through a period of years, "X" being the rate to be calculated, is

$$X = 1 - \sqrt[n]{\frac{S}{V}}$$

COST, $1,000; ESTIMATED LIFE, FIVE YEARS; ESTIMATED RESIDUAL VALUE, $100

AMOUNT TO BE DEDUCTED ANNUALLY

Years	Fixed Per-centage	Fractional method Weighted Years	Declining Balance Unscien-tific 20%	Declining Balance Scientific .36905	Sinking Fund	Reval-uation
1 year........	$180.00	$300.00	$200.00	$369.05	$162.87	$250.00
2 years.......	180.00	240.00	160.00	232.85	162.87	225.00
3 years.......	180.00	180.00	128.00	146.90	162.87	125.00
4 years.......	180.00	120.00	102.40	92.70	162.87	175.00
5 years.......	180.00	60.00	309.60	58.50	162.87	125.00
Depreciation..	$900.00	$900.00	$900.00	$900.00	$814.35	$900.00
Interest 5%...	....	....	....	....	85.65	
Residue.......	100.00	100.00	100.00	100.00	100.00	100.00
Total.......	$1,000.00	$1,000.00	$1,000.00	$1,000.00	$1,000.00	$1,000.00

VALUE OF ASSET AT END OF EACH YEAR

Years	Fixed Per-centage	Fractional Method Weighted Years	Declining Balance Unscien-tific	Declining Balance Scien-tific	Sinking Fund Method	Reval-uation Arbitrary
1 year........	$820.00	$700.00	$800.00	$630.95	$837.13	$750.00
2 years.......	540.00	460.00	640.00	398.10	666.12	525.00
3 years.......	360.00	280.00	512.00	251.20	486.56	400.00
4 years.......	180.00	160.00	409.60	158.50	298.02	225.00
5 years.......	100.00	100.00	100.00	100.00	100.00	100.00

Assets on which depreciation may be deducted.—Depreciation may be deducted only on such assets as are subject to wear and tear as a result of their use in connection with the business of the corporation, but no depreciation may be deducted on assets which are the stock in trade of the corporation. Under certain conditions, discussed in detail under Inventories (page 182, *ante*), this depreciation in value may be taken into consideration in valuing the asset for inventory purposes.

Where this is not allowed the shrinkage in value will be reflected in the sales when the assets are disposed of.

Depreciation of patents.—While a patent is not subject to any loss as a result of wear and tear, its life is limited to a maximum of seventeen years. The cost of the patent may be prorated over the number of years it has to run and the proportionate part deducted each year as depreciation. Where the patent has been secured from the Government by a corporation itself, its cost would be represented by the various Government fees, cost of drawings, experimental models, attorneys' fees, etc. These items should not be deducted as an expense in the year incurred, but should be capitalized and spread over the life of the patent. If the value of the patent were written up or appreciated on the books of the owner, depreciation could still be deducted only on its original cost, unless the appreciation in the value of the patent had been previously reported as income for income tax purposes, in which case depreciation could be deducted on the appreciated value. Where the patent has been purchased by the corporation for a cash consideration, the amount paid would represent the cost. Where the corporation has purchased a patent and paid for it in stocks or other securities, the actual value of such securities at the time of the purchase will be the cost of the patent to the corporation. Should the value of the patent disappear through obsolescence or any other cause, before the patent expires, the balance of the cost of the patent may be deducted as a loss.

Depreciation of other intangible assets.—A reasonable amount of depreciation may also be deducted on other intangible assets, with the exception of good-will. Copyrights, for example, are treated exactly the same as patents. Amounts paid in consideration of a contract having several years to run may also be charged off over the life of the contract.

Depreciation of good-will.—Good-will, for income tax purposes, is subject neither to appreciation nor to depreciation, regardless of whether or not it has been paid for by the corporation. Any amount charged off as a decrease in the value of good-will is not deductible. On the other hand, a surplus created by "writing-up" the value of good-will is not considered taxable income.

Necessity for book entry of depreciation.—The 1913 Income Tax law permitted the deduction of "a reasonable allowance for depreciation by use, wear and tear of property." It did not require that the amount claimed must be written off on the books in order to permit its deduction. The Treasury Department, however, held that the depreciation must be charged off on the books of the corporation to permit its deduction. On the strength of this ruling many income tax inspectors refused to allow the deduction of depreciation, solely on the ground that the amount had not been charged off on the books of the corporation. To remedy this condition the Commissioner of Internal Revenue issued a letter of instructions to collectors, from which the following is an extract:

"It is not the desire of this office to deny, upon purely technical grounds, a deduction which the law authorized and which conforms, or may be made to conform, to the regulations. Revenue agents and examining officers, in the examination of the books of a corporation, will, therefore, determine whether or not the deduction claimed in its return is a fair and reasonable measure of the loss sustained during the year, and, if they find that the amount claimed in a return is such fair and reasonable measure of the loss, and that it was not written off on the books of the corporation, they will permit the corporation to reopen its books if it so desires, and make such entries as will constitute the amount sought to be deducted, a liability against the assets of the company, and a charge against the income of the year for which the return is made. Sufficient time to make such correcting entries should be given to the corporation before the report of the examination is made to this office, and any recommendation as to additional taxes should be made accordingly.

"If a corporation refuses or neglects to reopen its books and write off the depreciation claimed in the return, or a reasonable amount measuring the loss sustained on this account, the amount claimed in the return will be disallowed."

Under the present Income Tax law, which affects returns for 1916 and 1917, the depreciation *must* be written off on the books of the corporation, as the wording of the law is "losses *charged off* within the year—including a reasonable allowance for the exhaustion, wear and tear of property, arising out of its use or employment in the business or trade."

Investment of depreciation reserve funds.—The original regulations of the Income Tax law provided that:

"Depreciation set up upon the books and deducted from gross income can not be used for any purpose other than making good the loss sustained by reason of the wear and tear, exhaustion or obsolescence of the property with respect to which it was claimed. If it develops that an amount has been reserved or deducted in excess of depreciation, the excess shall be restored to income and so accounted for.

"If any portion of the depreciation set up is diverted to any purpose other than making good the loss sustained by depreciation, the income account for the year in which such diversion takes place must be correspondingly increased."

The effect of this ruling was to give taxpayers the impression that the law required that the amount deducted for depreciation be set aside in a separate fund, and that the fund be kept intact or used only to make good losses caused by depreciation. This interpretation is contrary to business practice, which does not consider it necessary that the amount charged against income be set aside in a fund. This misconception as to the intention of Congress was so prevalent among Internal Revenue officers, that it was found necessary to issue a decision, which is herewith quoted in full:

The second paragraph under Sec. 12 of Title I of the Act of September 8, 1916, authorizes corporations, joint stock companies, etc., in making their returns of annual net income, to deduct from gross income:

All losses actually sustained and *charged off* within the year . . . including a reasonable allowance for the exhaustion, wear and tear of property, arising out of its use or employment in the business or trade and in the case of oil and gas wells and mines, a reasonable allowance for depletion of natural deposits.

The essential requirements of this provision are that the amounts deductible on account of depreciation and depletion shall be *charged off* and shall be reasonable allowances—that is, an amount sufficient to make good

the loss due to these causes. The phrase "charged off" contemplates that the "reasonable allowance" deducted from gross income on account of depreciation and depletion, shall be credited to appropriate reserve accounts and carried as a liability against the assets, to the end that when the total of these credits equals the capital investment account, no further deductions on these accounts will be allowed. While the presumption is that amounts credited to these accounts will be used to make good the loss sustained, either through a renewal or replacement of the property or a return of capital, there is no requirement of law that the funds represented by these reserve liabilities shall be held intact or remain idle against the day when they may be used in making good the depreciation of the property with respect to which the deduction is claimed, or in restoring the capital invested in the depleted assets.

The conversion of the depreciation reserve into tangible assets will not constitute such a diversion as would deny the corporation the right of deduction, provided in all cases, that the deduction claimed in the return is a reasonable allowance, that is, a fair measure of the loss due to "exhaustion, wear and tear of property growing out of its use," and is charged off or so entered upon the books as to constitute a liability against the assets with respect to which the depreciation deduction is claimed.

To the extent that Articles 130, 132 and 133 of Regulations No. 33 are in conflict with the foregoing they are hereby rescinded, and this decision is made applicable to the adjustment of return of annual net income made pursuant to the requirements of Section 38, Act of August 5, 1909, Section 2 of the Act of October 3, 1913, and the present Income Tax law, except that as to returns made under the first two Acts, the writing off of depreciation will not be insisted upon. (T. D. 2481)

DEPLETION

Distinction between depletion and depreciation. — Depreciation, as used by the Treasury Department, is limited to mean the lowering of value due solely to wear and tear.

Depletion is the decrease or lowering of the supply of a natural deposit, referred to as "Exhaustion," in the text of the law.

Depletion of mines.—The amount which may be deducted as an allowance for the depletion of mines depends upon two factors: the fair or market value of the natural deposit as of March 1, 1913, and the number of units in the deposit.

The fair market value as of March 1, 1913.—Section 12, subdivision (e), of the Law of 1916, authorizes the de-

duction of "a reasonable allowance for exhaustion, wear and tear of property and . . . in the case of mines, a reasonable allowance for depletion thereof, not to exceed the market value in the mine of the product thereof, which has been mined and sold during the period for which the return and computation are made . . . provided that when the allowance authorized shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made."

In the case of property purchased prior to March 1, 1913, the fair market value as of that date should be the value on March 1, 1913, of the entire deposits of minerals contained in the property owned, exclusive of the improvements and development work. It should be the price at which the natural deposits or mineral property as an entirety in its condition at that time could have been disposed of for cash or its equivalent.

The detailed method of arriving at the fair market value of the mineral deposits as of March 1, 1913, will vary with each corporation, the estimate in all cases being subject to the approval of the Commissioner of Internal Revenue.

When actual cost of the property may be used.—The actual cost of the property may be used as the basis for computing the amount of depletion (1) where the property was acquired subsequent to March 1, 1913, and (2) where the fair market value as of March 1, 1913, cannot be ascertained. In this case allowance should be made for the mineral which has been removed prior to that date.

Determination of the number of units contained in the property.—Having determined either the cost, or the fair market value as of March 1, 1913, an estimate of the number of units (tons, pounds, etc.) should be made. The value of the property divided by the esti-

mated number of units in the mine will determine the per unit value, which multiplied by the number of units mined during the year will give the amount to be deducted against the gross income of that year.

No instructions are given in any Treasury decision for determining the number of units in a mine. There is no doubt that an estimate submitted by a competent mining engineer would be an acceptable basis.

Calculating the amount of depletion to be deducted.—The question has been raised, as a result of rulings of the Treasury Department, as to whether the amount of annual depletion should be based on the number of units mined or upon the number of units sold.

The author believes that the calculation should be made on the basis of the number of tons mined, wherever records are kept so as to furnish this information, because the *depletion* occurs when the mineral is mined and not when it is sold. Mineral mined and not sold results in a depletion of the mine, and in an increase of the minerals on hand.

Bookkeeping requirements.—Every individual or corporation claiming and making a deduction for depletion is required to keep an accurate ledger account, to which should be charged the estimated fair value as of March 1, 1913, or the cost, if the property was acquired subsequent to that date, of the mineral deposits. The amount deducted each year for depletion should be credited against this account and when the credits to the account equal the debit no further allowance for depletion of the property will be allowed.

The fair market value as of March 1, 1913, or the cost, once determined, will be used as the basis for determining the depletion allowance. There can be no revaluation for the purpose of the depletion deduction, if it is found that the estimated quantity of mineral deposit was understated at the time the value was fixed or at the time the property was acquired. In other

words, the "per unit" depletion, once estimated, must be used in determining the amount of depletion as long as the property is under the same ownership. To illustrate: A mine cost $250,000 and is estimated to contain 1,000,000 tons of coal. This would permit a $0.25 per ton charge for depletion. After a number of years of operation it is discovered that the mine contained only 900,000 tons. The total amount of depletion deducted after mining the 900,000 tons would be $225,000. The balance of $25,000 should be deducted not as depletion but as a loss, because of the original error in estimating the number of units in the deposit.

Lessees may not deduct depletion. — The rules stated above apply only to the owners in fee of mines and mining property. Individuals or corporations operating a mine under lease or on a royalty basis are not entitled to any deduction for depletion. If, however, the lessee, in addition to royalties, paid or pays a stipulated sum for the right to explore, develop and operate a mine, the amount so paid may be ratably distributed over the life of the lease, or over the probable life of the mine under the ordinary operating conditions, and the lessee may deduct annually as rental payment an aliquot part of the amount of the stipulated sum so paid.

Statement to be attached to return.—There should be attached to the return a statement showing:

(1) Whether the operator is a fee owner or lessee;

(2) In the case of a fee owner;

a. The fair market value of the mineral deposits as of March 1, 1913, if the property was acquired prior to that date; or

b. The cost of the mineral deposit if acquired subsequent to that date;

(3) The method by which the value as of March 1, 1913, was determined in case the property was acquired prior to that date;

(4) The estimated quantity in units in the mine as of March 1, 1913, or at the date of purchase if acquired subsequent to that date;

(5) The number of units removed and sold during the year for which the return is made; and

(6) Any other data which would be helpful in determining the reasonableness of the depletion deduction claimed in the return.

In the case of a lessee, the statement should show:

a. The amount of the bonus or other payment made for the right to operate the mine;

b. The period covered by the lease.

Depletion of oil and gas wells.—A depletion allowance is deductible by owners of oil or gas wells, this allowance being designed to extinguish the capital invested at the time when the production of the well ceases. The depletion deduction allowed annually is such a percentage of the unextinguished capital as the reduction in flow or production of one year is a percentage of the flow or production of the previous year.

The invested capital, originally, is taken to be the fair market value of the gas or oil properties as of March 1, 1913, or the cost, if acquired subsequently, the figures being subject to the approval of the Commissioner of Internal Revenue. This valuation will be taken as the basis for determining the depletion deduction for all subsequent years while the property continues under the same ownership, and no revaluation will be permitted. When the depletion allowances amount eventually to the sum set up as the fair value, no further deduction for depletion with respect to the property and the capital so invested in it will be allowed.

Determining the reduction in flow.—The Income Tax law permits the deduction of "in the case of oil and gas wells, a reasonable allowance for actual reduction in flow and production, to be ascertained not by the

flush flow but by the settled production or regular flow."

Depletion—how determined.—The flow or production of a well as of March 1, 1913, or at the time of purchase, if acquired subsequent to that date, or as of the time when it has reached its stage of settled production or regular flow, if brought in as a new well subsequent to March 1, 1913, is taken as the basis upon which the percentage of decline is computed for the ensuing year.

If the total yearly yield of the well is not recorded, in order that the percentage of decline may be determined tests may be made of the production or flow at the same certain period of each year, as a basis for comparison.

In the case of a gas well, two methods of testing its rate of yield are accepted by the Department: (1) the volume of outflowing gas may be measured, or (2) the "rock pressure" may be ascertained by the use of a pressure gauge. The first method is the more accurate, but is sometimes objectionable because of the waste of gas during the process of measurement.

In the case of an oil well, the question of measuring the flow is simple, and if the basis is the natural flow, the computation of depletion is also simple.

If, however, the well has ceased to flow naturally and must be pumped, if oil is to be produced, the situation is so complicated that there seems to be no solution of the problem. Of course, the rate of decline in yield of the well could be ascertained. The actual determining element in ascertaining the possible production would be, in either case, the pressure (though in the case of the flowing well it would not be necessary to go beyond the measurement of the oil actually yielded by the natural flow), and when the pressure had declined so that there was not sufficient to force the oil to the elevation of the surface of the ground, the pressure would still be measureable at a sufficient

depth below the surface, and the decline could be estimated. The difficulty, however, lies in the fact that in such a case a number of new factors enter into the problem. If the well would yield a profitable amount of oil, if pumped, the owner might claim that the price of oil did not justify him in going to the expense of installing and operating the necessary machinery. If this were the case, it would seem that if there were still a part of the invested capital unextinguished, the well might be abandoned, and the difference between its original fair value and the sum of the depletion allowances which had been taken from it might be deducted in the tax report, not as allowance for depletion, but as a loss. In such a case, if the well had any market value, this value would be deducted from the amount charged off as a loss.

In the case of a well that was in the first place not a flowing well but a pumper, the depletion deductions could be ascertained, as in the case of a flowing well, by some means that would indicate the decline in pressure; but if, for instance, the pump took the oil from a point in the well 100 feet below the surface of the ground, as the pressure diminished the oil level in the well would subside without causing any decrease in yield (but only an increase in power required to operate the pump) until the level reached the pump, when the yield would cease abruptly and completely, necessitating either an abandonment of the well or the installing of a pump which would reach a greater depth. In this case, there might be no depletion, figured on a production basis, for several years, and then in one year there would be a 100 per cent depletion.

It would seem that there is need of definite rulings by the Department, covering such possibilities as these.

Depletion of oil field.—The Treasury Department has held that:

In the case of a field or territory in course of development or in which new wells are being drilled, if the depletion deduction is to be availed of in the returns of annual net income, each individual well or possibly each group of wells in operation at the beginning of, or brought in during the year, if the flow and production of the group of wells is so assembled as to be tested, must be tested at the end of the year in order that the decline in the flow and production may be determined.

New wells or new groups of wells brought in during the year may be tested as soon as they have reached the stage of settled production or regular flow, and then again at the end of the year. The decline in flow and production, if any, as indicated by these tests, will be reduced to a percentage basis and a like percentage of the capital invested in the oil or gas property (exclusive of machinery, equipment, etc.) will constitute an allowable deduction from the gross income of the year on account of depletion. Thus, if the decline in the flow and production during the year of, say, ten wells, costing $100,000 has been 5 per cent as compared with the production and flow as indicated by a test made at the beginning of the period, then 5 per cent of $100,000 or $5,000 will, for the year for which the computation is made, constitute an allowable depletion deduction in favor of the individual or corporation owning and operating the property.

If the wells are not so situated that their flow and production may be assembled in order to test and ascertain the reduction in the output as a basis for computing depletion, it will be necessary for the corporation or individual owning the property and claiming a depletion deduction, to take an accurate gauge of the production and flow of each well at a certain same period of each year, and by comparing this gauge with that of the previous year, determine the percentage by which the production and flow has been reduced. This having been done as to all of the wells in operation, an average percentage rate of reduction in flow and production will be ascertained, and this rate will be applied to the capital invested, that is, the value of the oil or gas property as of March 1, 1913, or the cost of the same, if acquired subsequent to that date, for the purpose of determining the amount which may be allowably deducted from gross income by such owning individual or corporation, on account of depletion.

In case of a field or territory fully developed and in which no new wells are being drilled, a comparison of the quantity of oil or gas produced during the year for which the computation is made with the quantity produced during the last preceding year, will disclose the reduction, and the percentage thus indicated of the reduction in flow and production of such field, will be the measure of the depletion deduction to be taken by the owner with respect to the capital invested in such field.

Notwithstanding the fact that the drilling of new wells may offset the reduction in the production and flow of the older wells in the field not fully developed, the provision of the law hereinbefore quoted, does not authorize, and this office cannot permit, a depletion deduction to be taken so long as the flow and production of the unit, be it a well or group of wells, or the entire territory, is as great during the year for which the return is made as it was for the year immediately preceding.

Statement to be attached to the return.—To each return made by an individual or corporation owning and operating oil or gas properties, there should be attached a statement showing:

1. (a) the fair market value of the property (exclusive of machinery equipment, etc.), as of March 1, 1913, if acquired prior to that date; or

(b) the actual cost of the property if acquired subsequent to that date;

2. How the fair market value of the property as of March 1, 1913, was ascertained;

3. The quantity of oil or gas produced during the year for which the return was made;

4. The quantity produced during the year immediately preceding;

5. How the depletion deduction claimed in the return was computed; whether upon the decline in flow and production of individual wells, groups of wells, or the entire field; and

6. Any other data which would be helpful in determining the reasonableness of the depletion deduction claimed in the return.

No depletion to be deducted by lessees.—Individuals and corporations operating oil or gas wells as lessees are not permitted any deduction for depletion of the oil or gas deposits. They may deduct annually, as a rental payment, an aliquot part of any bonus paid for the right to enter upon, explore, develop and operate oil or gas territories.

Depletion of timberland.—Though the Income Tax law does not specifically provide for an allowance for the depletion of timberlands, the Treasury Department recognizes that the income from the sale of timber of the lumber manufactured from it includes a return of the capital invested in the timberland and permits a reasonable deduction for the cost of the timber sold.

This deduction may be shown on the report in any one of three ways:

1. As a deduction from the gross receipts.
2. As an expense of production.
3. As an allowance for depletion.

In order to secure the benefit of the deduction the individual or corporation must comply with the same bookkeeping requirements as described in the preceding paragraphs in the case of mines.

The method of determining the amount of the deductions is also the same as in the case of mines. The fair market value as of March 1, 1913, of the timberland *en bloc* must be estimated, unless the timberland was acquired subsequent to that date, in which case the actual cost must be used. An estimate must be made of the number of board feet in the entire timber holdings. Dividing the fair value (as of March 1, 1913, or the cost if acquired subsequent to that date), by the number of board feet gives the cost per foot of the timber. The cost per foot multiplied by the number of feet logged during the year for which the return is made will give the amount which may be deducted either as a cost of operations or as an allowance for depletion.

No deduction will be permitted after the original cost, or the fair market value as of March 1, 1913, is extinguished.

The total amount realized for the logged-off lands or other salvage should be returned as income in the year in which such lands were disposed of, or in the year in which payment was received, according to the basis upon which the income accounts are kept.

Depletion of land.—As hereinbefore stated, land used in agriculture is subject to depletion in the form of loss of fertility. The determination of the loss due to this depletion is apt to be difficult. The Treasury Department has not as yet issued any regulations as to

the method of determining the deduction for depletion. In the absence of any instructions the taxpayer should rely upon his own judgment. In all such cases the deduction should be supported by a statement showing in detail how it was calculated.

Reserves deductible by insurance companies.—The Income Tax law, section 12, subdivison (a), provides for the deduction of, "in the case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts."

The proper calculation of this deduction depends upon the requirements of the laws of the various States in which the insurance company operates. A number of cases have arisen on the question of the requirements of the various State laws, among which may be mentioned *Maryland Casualty Co. vs. United States,* decided by the Court of Claims, February 12, 1917, and *McCoach vs. Insurance Company of North America,* decided by the United States Supreme Court, June 11, 1917.

Where the reserve requirements of the States in which the company operates differ, the amount which may be deducted is the highest amount required by any of the States.

INTEREST

Limitations upon the amount of interest deductible.—With certain exceptions, interest paid (or accrued in cases where the corporation keeps its books upon an accrual basis) by a corporation on its indebtedness is deductible only to the extent of interest on so much of the indebtedness as is not in excess of the sum of:

(a) the par value of the entire amount of the paid-up capital stock outstanding at the end of the year; or if the capital stock has no par value, or if the company

has no capital stock, the entire amount of the capital employed in the business at the close of the year, and

(b) one-half of its interest-bearing indebtedness then outstanding.

This arbitrary limitation often has the effect of taxing corporations upon income which they have not earned. It is particularly severe upon corporations organized with a small capital. In one case, the tax assessed was greater than the actual net income of the corporation. The constitutionality of this provision has, however, been upheld by the United States Supreme Court in a number of cases.

Interest not subject to restriction.—The severity of the limitation as imposed by the act of October 3, 1913, has been lessened by changes in the act of September 8, 1916, exempting certain classes of interest payments from the limitation. These classes of interest payments are three in number:

1. Interest paid for the use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.
2. Interest paid on indebtedness wholly secured by property collateral, which is the subject of sale or hypothecation in the ordinary business of the corporation.
3. Interest paid on deposits, or on moneys received for investment and secured by interest-bearing certificates of indebtedness by banks, banking associations, and loan or trust companies.

Interest not deductible.—Interest on obligations incurred for the purchase of obligations or securities the interest upon which is entirely exempt from the income tax is not deductible. This would include the interest on all obligations of the States or any subdivision of a State and any of the obligations of the United States, including interest on Liberty 3½s and 4s. No super-tax being imposed upon corporations, and the interest on Liberty bonds being subject only to the super-tax,

in the hands of corporations such interest is entirely exempt.

Interest paid for the use or possession of property.—A corporation may rent property under a lease the terms of which require the lessee corporation to pay, as a rental equivalent, the interest on the bonds of the lessor company. The amount of interest so paid may be deducted as a rental payment, as hereinbefore explained.

If, however, the lessee corporation *assumes* the outstanding bonds of the lessor corporation, such bonds will be considered, for the purpose of the income tax, to be part of the lessee corporation's own indebtedness, and the interest paid on such bonds will be considered as interest paid on the indebtedness of the lessee corporation.

Interest on indebtedness wholly secured by property collateral the subject of sale or hypothecation in ordinary business.—Section 12, subdivision (a), provides: "That in the case of indebtedness wholly secured by property collateral, tangible or intangible, the subject of sale or hypothecation in the ordinary business of such corporation, joint stock company or association as a dealer only in the property constituting such collateral, or in loaning the funds thereby procured, the total interest paid by such corporation, company or association within the year on an such indebtedness may be deducted as part of its expenses of doing business, but interest on indebtedness shall only be deductible on an amount of such indebtedness not in excess of the actual value of such property collateral."

The clearest statement as to what indebtedness falls within the above provision is found in T. D. 1993, which states that "the only corporations, joint stock companies, or associations, which will be allowed under this proviso, as herein interpreted, to deduct as an expense of doing business interest paid on indebtedness wholly secured by mortgage on real estate, or other physical property, are those corporations, joint

stock companies or associations which are organized and operated for the exclusive purpose of buying, selling and dealing in the particular kind of property upon which the mortgage is given, and the particular property pledged for the debt upon which the interest is paid must be the subject of sale in the ordinary business of the corporation.

"Any corporation whose indebtedness is secured by a trust mortgage, or by any form of indenture which covers and includes in the lien any property, which is not the subject of sale in the ordinary business of such corporation, will be and is excluded from the benefit of this proviso, and its interest deduction will be limited to the amount authorized in subdivision third [quoted on the preceding page]."

Amount of indebtedness secured by collateral to be shown separately.—In order to take advantage of the provision permitting the deduction of interest on its indebtedness secured by collateral, corporations are required to show the amount of such indebtedness in a supplementary statement, which should be separated from the statement of the amount of indebtedness which is not so secured and the interest on which is deducted as interest paid.

Interest paid by banks on deposits.—The Income Tax law section 12, subdivision (a) provides further that: "In the case of a bank, banking association, loan or trust company, interest paid within the year on deposits on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company, shall be deducted."

To come within this provision

1. The corporation must be organized as a bank or banking institution.

2. The interest must be paid on money deposited or on money received for investment.

The corporation must be organized as a banking insti-

tution.—The corporation must be organized as a bank or trust company. Corporations receiving deposits from their employees and paying interest thereon are not permitted to deduct such interest as interest paid on deposits, but must deduct it as interest paid, subject to the limitation on such deduction.

Interest must be paid on deposits.—The interest, in order to come within the above provision, must be paid on moneys deposited or on moneys received for investment secured by interest-bearing certificates of indebtedness. The obligation on which the interest is paid must be the obligation of the corporation itself.

In the case of *Middlesex Banking Co. vs. Eaton* (221 Fed., 86) (affirmed 233 Fed., 87) the court held that a corporation selling debenture bonds and guaranteed real estate securities by a method by which it both paid and received interest, the difference between the amounts paid and the amounts received being its gross income, was not paying interest on deposits and therefore was not permitted to deduct the interest paid as interest paid on deposits. In this case the corporation would be permitted to deduct the interest as paid on indebtedness secured by collateral the subject of sale, the mortgages being considered the collateral.

CALCULATING THE AMOUNT OF INTEREST DEDUCTIBLE

Factors to be considered.—All interest paid by the corporation, unless it comes within the classes mentioned in the preceding paragraphs, is deductible only to the extent provided by the law. The amount which may be deducted as interest paid on indebtedness depends on three factors:

1. The amount of paid up capital stock outstanding (if no capital stock the amount of capital employed in the business) at the end of the year.

2. The amount of interest-bearing indebtedness outstanding at the end of the year.

3. The contract rate of interest.

Capital stock outstanding at the end of the year.—"Paid-

up capital stock outstanding at the close of the year," when used in connection with the limitation on the interest deduction means the par value of the shares issued and outstanding on the last day of the year for which the return is made and which have been fully paid up. Preferred capital stock must be included as capital stock outstanding, and the dividends thereon may not be deducted as interest.

The term "issued and outstanding" does not include any treasury stock; that is, stock issued and subsequently acquired by the corporation.[1] But the stock which is part paid should be included to the extent of the payments in the stock. It makes no difference whether such stock is issued or not. Thus, in the case of stock sold payable in installments at definite times or as assessed, only so much as has been actually paid in on the stock should be reported.

In the case of shares issued without par value, the amount of the capital stock outstanding will be the amount actually received for such shares when they were issued.

If such shares are issued as a bonus in connection with shares of preferred stock, which must necessarily have a par value, the entire capital paid in is represented by the par value of the preferred stock. The "paid-up capital stock" will be the par value of the preferred stock.

If both common and preferred stock are issued for cash or its equivalent, the paid-up capital stock will be the par value (if fully paid in) of the preferred stock plus the amount actually paid in on the shares issued without par or nominal value.

Capital employed in the business.—If the corporation has no capital stock the amount of capital actually employed in the business at the end of the year should be used in determining the amount of interest deductible.

[1] As used in the Capital Stock tax regulations "outstanding" *is* held to include treasury stock.

Capital employed in the business, as here used, means the entire capital paid in by the members of the company, including so much of the accumulated surplus as is actually employed in the business, but does *not* include any borrowed capital.

Interest-bearing indebtedness outstanding at close of year.—The interest-bearing indebtedness outstanding at the end of the year does not include preferred stock. Bonds secured by property which the corporation has leased and which have been *assumed* by the lessee corporation should be included. Such overdue accounts payable, on which the corporation is obligated to pay interest, may be included as interest-bearing indebtedness. There should be attached to the return a statement of the amount, character, and the contract rate of interest of each item of the indebtedness.

Calculating the amount of interest deductible.—The sum of the outstanding capital stock plus *one half* of the outstanding interest-bearing indebtedness is the maximum amount on which the interest paid may be deducted.

Where the indebtedness bears interest at various rates, the indebtedness bearing the highest rate may be considered first in computing the deduction.

The method of computing the deduction is illustrated by the following example:

A corporation's paid-in capital stock outstanding on December 31, 1917, is as follows:

1,000 shares common par $100	$100,000
500 shares preferred par $100	50,000
Total capital stock	$150,000

The outstanding indebtedness is as follows:

$150,000	First mortgage $4\frac{1}{2}$ per cent bonds
100,000	Second mortgage 5 per cent bonds
75,000	Debenture bonds—6 per cent
50,000	3-year—6 per cent notes
$375,000	Total interest bearing indebtedness

Total capital stock outstanding......	$150,000
One-half of the interest-bearing indebtedness	187,500
Total indebtedness upon which interest paid is deductible	$337,500

Interest deductible:

6 per cent on	$50,000	$3,000.00
6 per cent on	75,000	4,500.00
5 per cent on	100,000	5,000.00
4½ per cent on	112,500	5,062.50
	$337,500	$17,562.50

The maximum amount of interest which may be deducted is, therefore, $17,562.50.

TAXES

Taxes paid within the year deductible.—All taxes paid or accrued within the year imposed by the authority of the United States or its territories, or possessions, or any foreign government, or under the authority of any State or any subdivision thereof, are deductible, with the following exceptions:

1. Taxes assessed against local benefits.
2. Income taxes imposed by the United States.[1]
3. Excess profits taxes imposed by the United States.

Income taxes paid in 1917 are not allowed as a deduction by the amendments to the act of September 8, 1916. Those corporations which accrued their income taxes on their returns for any period prior to January 1, 1917, were permitted the deduction under the original provisions of the act of September 8, 1916. The amendment of October 3, 1917, is, however, retroactive to January 1, 1917. All corporations which accrued their income taxes on their income tax returns for any period ending in 1917 are subject to an additional tax on such an amount.

[1] Income taxes paid to foreign Governments are deductible.

Excess profits taxes, while not allowed by the law as a deduction, are permitted as a credit. This distinction between deduction and credit is made in the law because the net income of the corporation may be subject to an excess profits tax. The amount of the excess profits tax assessed on this net income is to be deducted before computing the income tax.

State taxes paid.—State franchise and State income taxes paid to any State come within the definition of "taxes paid to any State" and may be deducted.

Prepaid taxes.—If a tax payment made in the present period is partly or entirely for the benefit of future periods, and the corporation keeps its accounts on an accrual basis, only so much of the taxes paid as are for the present period may be deducted. Taxes paid for the benefit of future periods should be carried on the books as a deferred asset and charged off as an expense during the future periods. For example, a corporation pays a tax of twenty cents for each hundred dollars par value of bonds it owns for the purpose of having them exempted from a municipal personal property tax for a period of five years. In that case four cents for each hundred dollars par value of bonds so exempted should be deducted as an expense during each of the five years.

Taxes paid by banks for stockholders.—Taxes paid by banks or other corporations on the value of their capital stock outstanding and in the hands of their stockholders are not deductible. Such taxes are a primary liability of the stockholder and as such are chargeable against the income of the individual and not against the income of the corporation.

Taxes paid on tax-free covenant bonds.—Where a corporation, pursuant to a guarantee in its bonds that the interest on the bonds will be paid without any deduction for taxes assessed against them, pays the income tax on such interest, it may not deduct the taxes so paid.

CHAPTER X

INCOME TAX ON CORPORATIONS

RATE OF TAX AND RETURNS

Rate of income tax.—The act of October 3, 1913, imposed a tax of 1 per cent on the entire net income, exclusive of interest on bonds of the United States, of any State or any subdivision of a State. The act of September 8, 1916, changed the rate of tax to 2 per cent.

The act of October 3, 1917, imposed an additional tax of 4 per cent upon the net income of corporations, but provided that for the purpose of this tax dividends received on stock of corporations which were themselves subject to the income tax could be deducted.

For the year 1917, therefore, corporations will be taxed at the rate of 6 per cent on net income exclusive of dividends and at the rate of 2 per cent on income received in the form of dividends.

Additional 10 per cent tax.—In addition to this tax the corporation may be subject to an additional tax of 10 per cent on such of its income as is neither invested in nor retained for the reasonable requirements of the business of the corporation. This additional tax is imposed by the amendment of October 3, 1917.

This amendment imposes a tax of ten per cent upon such part of the net income of every corporation as remains undistributed six months after the close of its calendar or fiscal year.

The tax will not be levied if the undistributed net income is:

1. Invested or employed in the business, or

2. Retained for employment in the reasonable requirements of the business, or

3. Invested in obligations of the United States issued *after* September 1, 1917.

The intention of this provision is the same as that which appeared in the act of October 3, 1913, and which provided that the income of individuals for the purpose of the super-tax would be held to include their undistributed share of the profits of any corporation which was permitting its profits to accumulate beyond the reasonable requirements of the business.

This provision is not intended to compel corporations to pay out their income in dividends. The fact that a corporation does not pay any dividends, but uses its income to expand its business, does not make it subject to the tax. But corporations which retain their income beyond the reasonable requirements of the business for the purpose of evading the surtaxes imposed upon the income of the individual stockholders would be subject to this tax.

The granting of excessive loans to stockholders or the excessive investment in tax-exempt securities would be evidence of the retaining of income beyond the reasonable requirements of the business. In all cases the question as whether or not the income is properly retained is to be passed upon by the Secretary of the Treasury. To enable him to determine this, income tax form 1031 requires corporations to show how much of their income for the preceding taxable year remained undistributed at the close of that year, and three and six months thereafter.

Rate of tax when fiscal year is established.—Where a corporation has established a fiscal year other than the calendar year and the rates in effect for the calendar years covered by the fiscal year differ, the income of the fiscal year should be apportioned as between the two calendar years in which it lies and the rate of tax in effect for each of the calendar years should be applied to such part of the income as is determined to be earned within each calendar year. The apportioning of

the income must be on the basis of the number of months of the fiscal year falling within each of the calendar years. To illustrate:

The *X Y Z Corporation's* fiscal year ends October 31st. Its income for the year ended October 31, 1917, was $120,000. This income should be apportioned as between 1916 and 1917; two-twelfths, or $20,000, is held to be earned in 1916 and the remaining ten-twelfths, or $100,000, as earned in 1917; $20,000 of the income of the corporation will be subject only to the 2 per cent tax imposed by the 1916 law.

Act of October 3, 1917, retroactive to January 1, 1917.—The additional tax imposed by the act of October 3, 1917, applies to income of corporations for the entire year of 1917. Corporations which have filed a return for a fiscal year ending within the calendar year 1917 will be assessed an additional tax of 4 per cent on such portion of their income, exclusive of dividends, as is held to be earned in 1917.

This tax will be assessed against all corporations, and in the case of corporations which have dissolved subsequent to the filing of their returns, the government will look first to the officers, then to the directors, and failing here, to the stockholders. It would seem, however, that only the stockholders would have any legal liability to pay such a tax, and then only in case they had received a distribution of the assets of the corporation.

Tax rates on dividends.—As stated in the discussion of income from dividends, dividends are to be taxed at the rates in effect for the year in which the surplus or profits out of which they are paid were earned. For the years 1913, 1914 and 1915, the rate of tax on income in the form of dividends was at one per cent. For the years 1916 and 1917 dividends were taxed at 2 per cent.

Dividends received in 1917, but paid out of profits earned in 1913, 1914 or 1915 should be taxed only at the rate of one per cent. The rules for determining out

of which year's income a dividend is paid are laid down in the discussion referred to above.[1]

RETURNS

Returns may be made for calendar or fiscal year.—A corporation may report its income either for a calendar year or for a fiscal year. If it makes its return on the basis of a fiscal year, the corporation must file a notice of its intention with the collector of internal revenue for the district in which it has its principal office, at least 30 days before March 1, of the year in which the return would otherwise be required to be filed.

Changing from calendar to fiscal year.—Where a corporation has made its previous return or returns on the basis of a calendar year and desires to file its returns on the basis of a fiscal year, it must file a notice designating the fiscal period not less than thirty days prior to March 1, of the year the calendar year report would otherwise he required to be filed in and make a return on or before March 1 of the income between January 1, and the fiscal date of the preceding year.

To illustrate:

1. The last income return was filed March 1, 1917, for the calendar year 1916.
2. It was determined to establish June 30, as the end of the fiscal year.

In such a case it will be necessary to:

1. File notice of the new fiscal year not later than January 29, 1918.
2. A return must be filed on or before March 1, 1918, for income from January 1, 1917 to June 30, 1917.
3. A return must be filed on or before August 29, 1918, for the fiscal period July 1, 1917 to June 30, 1918.

Returns required of all corporations.—The duty to make a return exists regardless of whether there is any in-

[1] See pages 78-88.

come or not. Every corporation or business association in existence, not specifically enumerated as exempt shall make a return of net income whether or not there is any income liable to tax. This applies to new corporations and corporations which have gone out of business during the year.

Subsidiary corporations are considered as separate corporations and must render separate returns.

When the name of a corporation is changed it is not considered a new corporation. The fact that the name had been changed should be noted on the return.

If a distinct new corporation was organized to take over the property of the old, both corporations will be required to make separate returns covering the period of the year that each respectively was operating the business.

Receivers, trustees in bankruptcy, or assignees must make returns for the corporation whose property or business they are operating.

When return must be filed.—Returns of net income for the calendar year must be filed on or before March 1 of the following year. The time for filing returns for the year 1917, however, has been extended to April 1, 1918.

Returns of net income for a fiscal year must be filed within 60 days after the close of the fiscal year for which the return is made.

The return must be placed in the United States mails, properly addressed with postage paid, so that there will be ample time to reach the office of the collector in the district wherein is located the principal place of business of the corporation on or before the last day upon which the return is due. When the last day is a Sunday or legal holiday the next day following will be considered the last day.

Tentative returns.—All corporations, if unable to assemble the data in time to make the return within the prescribed time may advise the collector of this fact and file a tentative return approximating the income of

the year. This tentative return must be substituted by a true and accurate return as soon as the actual figures are available.

Extensions of time, assessment and payment of tax.—All the provisions regarding the granting of extensions of time for the filing of returns, the assessment and payment of taxes explained in connection with the individual returns apply equally to corporations and are therefore not repeated in this chapter.

The Preparation of Form 1031.—*Gross Income* is to be reported under five headings as follows: (1) Gross sales and other income from operations (pp. 181-189); (2) Income from rentals, royalties, etc. (pp. 191-193); (3) Income from interest (pp. 194-195); (4) Income from dividends (pp. 195-198); (5) Income from all other sources (pp. 198-205). The item "Gross sales and other income from operations" is the gross receipts from sales or other operations. The cost of such sales is to be reported under deductions as an expense of business.

Deductions are divided into four classes: (1) Cost of goods sold and expenses of business (pp. 181-188 and 206-216); (2) Losses charged off, including depreciation and depletion (pp. 217-342); (3) Interest paid (pp. 243-249); (4) Taxes paid (pp. 250-251).

Calculation of Tax.—The total gross income reported less the total deductions gives the total net income (line 8 of report). From this amount should be deducted the amount of excess profits tax as determined either on this form or on form 1101 (see Chapter on Excess Profits Tax) and also such dividends or parts of dividends as were paid out of profits accumulated in 1913, 1914 and 1915. These dividends are taxable at the rate of 1 per cent. The resulting figure is the amount of income subject to the 2 per cent tax imposed by the act of September 8, 1916 (line 9a). The amount of dividends deducted above as earned in 1913, 1914 or 1915 is taxable at the rate of 1 per cent, which is the rate in effect for those years (line 9b). Returning to the amount shown on line 8 we deduct: 1, the amount of excess profits tax, and, 2, the total amount of dividends received. The resulting amount is subject to the extra 4 per cent tax imposed by the act of October 3, 1917 (line 11).

If the corporation reports on the basis of a fiscal year the extra 4 per cent tax will be computed on as many twelfths of the amount shown on line 11 as there are months from January, 1917, to the close of the fiscal year.

The total tax is the sum of:

1. Amount of Excess Profits Tax;
2. Tax at 2 per cent on amount on line 9a;
3. Tax at 1 per cent on amount on line 9b;
4. Tax at 4 per cent on amount on line 11.

CHAPTER XI

"WITHHOLDING," "DEDUCTION" AND "INFORMATION" AT THE SOURCE

Prior to the amending of the Income Tax law by the act of October 3, 1917, deduction at the source was one of the basic features of the collection of the tax.

"Withholding" provisions of the 1916 Income Tax law.—Under the provisions of the 1916 law all interest on bonds and other similar obligations of domestic corporations was subject to the withholding of the normal tax of 2 per cent, whether such interest accrued to citizens and residents of the United States or to non-resident alien individuals, unless an exemption up to $3,000 or $4,000 was claimed by the individual. All other forms of periodical profits or income in excess of $3,000 or $4,000 were subject to withholding of the normal tax at the rate of 2 per cent.

The withholding of the tax at the rate of 2 per cent also applied to interest on bonds, etc., of domestic corporations received by non-resident alien corporations and partnerships.

Dividends on stock of domestic corporations paid to foreign corporations having no office or place of business in the United States was also subject to withholding at the source at the rate of 2 per cent.

The amendments made by the act of October 3, 1917, have practically eliminated withholding at the source, as far as citizens and residents of the United States are concerned.

The various provisions as to withholding at the source in effect on and after October 4, 1917, may be summarized as follows:

Withholding of tax from payments made to citizens or residents of the United States.—The normal income tax is not to be deducted and withheld from any payment of income made to a citizen or resident of the United States except when derived from a bond, mortgage or other obligation issued by a domestic or resident corporation, which contains a contract or provision by which the obligor agrees to pay any portion of the tax imposed by the Federal Income Tax Law upon the obligee, or to reimburse the obligee for any portion of the tax which the obligor may be required or permitted to pay thereon, or to retain therefrom, under any law of the United States. That is, if interest is paid upon any obligation of a domestic or resident corporation, joint-stock company, etc., which contains a so-called "tax-free" or "no deduction" clause to a citizen or resident of the United States normal tax at the rate of two per cent is to be withheld, unless personal exemption is claimed and then only from the amount paid in excess of the exemption claimed.

Domestic partnership.—There is to be no withholding at the source of any income accruing to any domestic partnership.

Domestic corporations or foreign corporations having a place of business within the United States.—There is no withholding at the source of any income accruing to corporations organized under the laws of the United States or any State, or to foreign corporations having an office or place of business within the United States.

Income withheld from non-resident alien individuals.—All persons, corporations, partnerships, associations or insurance companies paying any amount of fixed or determinable gain, profit or income, other than that paid as dividends on the capital stock or from the net earn-

ings, profits or income of corporations, joint-stock companies, etc., subject to a like tax, to a non-resident alien *individual* are required to deduct and withhold normal tax at the rate of two per cent from the entire amount paid. But salaries paid to non-resident aliens for services rendered entirely outside of the United States are not subject to the tax and, therefore, no withholding at the source is required.

Interest on bank deposits accruing to non-resident alien individuals is subject to withholding at the rate of 2 per cent.

Non-resident partnerships exempt.—There is no withholding at the source of any income accruing to any foreign partnership, regardless of the character of the income.

Withholding from non-resident corporations.—Normal income tax at the rate of 6 per cent is to be withheld from all payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of domestic or other resident corporations, joint-stock companies, associations or insurance companies, when paid to foreign corporations, joint-stock companies, associations or insurance companies having no office or place of business in the United States.

When dividends upon the capital stock or from the net earnings of domestic or other resident corporations, joint-stock companies, associations or insurance companies, are paid to foreign corporations, joint-stock companies, etc., having no office or place of business in the United States, normal tax at the rate of 2 per cent is to be withheld.

A recent ruling of the Treasury Department, however, provides that interest on bank deposits paid to non-resident corporations is *not* subject to withholding of the tax. Of course, non-resident corporations are nevertheless liable to pay the tax on such interest.

The statements made hereinbefore are brought out more clearly by the following chart:

Rate of tax to be withheld on various items of income.

Recipient	Interest on Bonds and Other Obligations of Domestic Corporations	Dividends on Stock of Domestic Corporations	Miscellaneous Income
1. Citizens and Residents of the United States..........	None*	None	None
2. Domestic Partnerships............	None	None	None
3. Domestic and Resident Corporations	None	None	None
4. Non-resident Alien Individuals.......	2%	None	2%
5. Foreign Partnerships............	None†	None	None
6. Non-resident Alien Corporations.....	6%	2%	6%‡

Definition of the "United States."—It will be seen that no withholding of income applies to any income accruing to any individual or organization resident in, or a citizen of, or organized in, the United States. A definition of the words United States is given in the law.

Section 15 of the Income Tax Law provides "That the word 'States' or 'United States' when used in this title shall be construed to include any Territory, the District of Columbia, Porto Rico, and the Philippine Islands, when such construction is necessary to carry out its provisions." The law further states in Section 23, "That the Provisions of this title shall extend to Porto Rico and the Philippine Islands; *Provided,* that the administration of the law and the collection of the

* Interest on bonds containing tax free covenant clause is to be paid by issuing corporation.

† According to an informal decision of the Treasury Department, Oct. 20, 1917, there will be no withholding on any income accruing to non-resident partnerships. A reading of section 13, subdivision (e), of the law as amended would make it evident that Congress intended that it should apply, but a technical error prevents it from applying.

‡ Except interest on bank deposits. See p. 260.

taxes imposed in Porto Rico and the Philippine Islands shall be by the appropriate internal revenue officers of these governments, and all revenues collected in Porto Rico and the Philippine Islands thereunder shall accrue intact to the general governments thereof, respectively."

The added War Income tax imposed by Title I of the act of October 3, 1917, does not apply to Porto Rico or the Philippine Islands.

No tax will be withheld at the source on any income accruing to any citizen or resident of Porto Rico or the Philippines or to any partnership or corporation organized in or having an office in Porto Rico or the Philippines.

Procedure in "withholding."—The Income Tax law, sec. 9, subdivision b, states that:

"All persons, corporations, partnerships, associations and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, receivers, conservators, employers, and all officers and employees of the United States having the control, receipt, custody, disposal or payment . . . [of income subject to withholding] . . . are hereby authorized and required to deduct and withhold from such . . . [income] . . . such sum as will be sufficient to pay the normal tax imposed thereon by this title, and shall make return therefor on or before March 1, of each year and, on or before the time fixed by law for the payment of the tax, shall pay the amount withheld to the officer of the United States Government authorized to receive the same, and they are each made personally liable for such tax, and they are each indemnified against every person, corporation, partnership, association, or insurance company, or demand whatsoever for all payments, which they shall make in pursuance and by virtue of this title."

Every person who under the provisions of the law is authorized to withhold taxes is required to make an annual return, which must be filed on or before March 1, of the following year, with the collector of internal revenue for the district in which the withholding agent has his principal place of business.

The return should not be filed before 30 days prior to March 1 (i.e. Jan. 29), as claims for deductions may

be filed with the withholding agent up to that date (i.e. Jan. 29) by the party subject to withholding.

From this return an assessment is made and a notice sent to the withholding agent. The tax must be paid by June 15th, and any failure to pay the tax subjects the withholding agent to the same penalty as failure to pay his regular income tax.

Repayment of tax withheld during 1917.—The Income Tax law as enacted September 8, 1916, provided for withholding from citizens and residents of the United States the tax on all interest from bonds and on payments of fixed and determinable income in excess of $3,000 or $4,000 as the case might be, at the rate of 2 per cent. This provision was in effect from January 1, 1917, to October 3, 1917. On Oct. 4, 1917, the withholding provision, in so far as it affected citizens and residents of the United States, was repealed. All income which was withheld at the source (other than interest on "tax-free" bonds) is to be returned to the person entitled to same.

Neither the law nor the Treasury Department gives any indication as to how this is to be done. Apparently, the individual entitled to the refund will have to make a claim upon the withholding agent for a refund of the amount withheld. Most reputable banks and corporations have refunded any tax withheld to the person entitled to it without waiting for a claim to be made upon them.

Deduction of interest on bonds and other obligations of domestic corporations.—Interest on bonds of domestic corporations accruing to a non-resident alien individual is subject to withholding at the rate of 2 per cent.

Interest on bonds or other obligations of domestic corporations accruing to non-resident alien corporations is subject to withholding at the rate of 6 per cent.

Interest on bonds of domestic corporations accruing to citizens or residents of the United States is not sub-

ject to withholding, *but* if the bond contains a contract or provision "by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee or to reimburse the obligee for any portion of the tax or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon or to retain therefrom under any law of the United States," the corporation will be required to withhold and pay over the tax. (War Income Tax Law, sec. 9, c).

Generally speaking, for the purpose of the tax there are two classes of bonds, registered and coupon.

Registered bonds are those bonds the interest on which is payable to the registered owner of the bond.

Coupon bonds are those bonds, the interest on which is payable by means of interest coupons attached to the bond. These coupons are dated, are in the form of a check, and may be deposited in any bank for credit and collection.

The duties of the owner of the bonds, the issuing corporation and the bank paying the interest, in connection with registered bonds, are entirely different from their duties in connection with coupon bonds.

Duties of Issuing Corporation in paying interest on registered bond.—The duty of the corporation is to withhold the tax at the rate of 2 per cent if the actual owner is a non-resident alien individual, and at the rate of 6 per cent if the actual owner is a non-resident alien corporation.

No tax need be withheld if the actual owner of the registered bonds is a citizen or resident of the United States, a partnership, either foreign or domestic, or a domestic or resident corporation (unless the bond contains a tax-free covenant clause, in which case the tax no doubt would be assumed by the debtor corporation, if the owner were an individual, whether resident in the United States or elsewhere).

The corporation is liable under the provisions for withholding of the tax on the basis of the record ownership of the bonds, unless it receives notice that the record owner is not the true owner and that the true owner is not subject to withholding. On the other hand, the corporation is under no obligation to look beyond the record owner to find out whether or not the true owner would be subject to withholding, but it is obliged to withhold in case the true owner is disclosed to it as one who is subject to withholding.

Duty of the record owner of registered bonds.—If the record owner of the bond is a non-resident alien corporation and the actual owner is a non-resident alien individual the actual owner should file a statement disclosing the true ownership. Upon receipt of this notice the issuing corporation will withhold only at the rate of 2 per cent.

If the record owner of the bond is a non-resident alien individual or corporation and the actual owner is a person, partnership or corporation not subject to withholding, the actual owner should file a statement of true ownership, in which case the issuing corporation would not withhold at all.

If the record owner is an individual or organization whose income is not subject to withholding, and the actual owner is an individual or organization subject to withholding (i.e. a non-resident alien individual or non-resident alien corporation) there is no obligation on the part of the record owner to reveal to the issuing corporation that the actual owner is subject to withholding.

As receiver of income belonging to the non-resident alien individual or corporation (actual owner) the record owner becomes the agent of the actual owner, and is required to file a return of the income of the actual owner that is in his possession. This obligation to file a return for the actual owner applies only if the record

owner is a citizen or resident of the United States or a domestic or resident corporation.

Right of actual owner of registered bonds.—Where the actual owner is a non-resident alien individual and the record owner a non-resident alien corporation, the actual owner may file a statement of actual ownership so that the tax will be withheld at the rate of 2 per cent instead of at the rate of 6 per cent.

If the actual owner is not subject to withholding but the record owner is a non-resident alien individual or corporation, the actual owner has the right to file a statement of actual ownership with the issuing corporation so that the tax will not be withheld.

Where the actual owner has not taken advantage of his right to file a statement of true ownership, and the tax has been withheld in excess of the actual owner's liability, he may apply for a refund in the manner described under "Refund of Taxes," p. 27.

Duties of banks in connection with payment of interest on registered bonds.—The issuing corporation is the sole withholding agent for interest on registered bonds. No duty as to withholding is imposed upon any bank collecting or paying the interest on these bonds unless the bank is the paying agent of the corporation.

Tax-free covenant bonds.—A large proportion of the corporate mortgages outstanding in the United States contain some form of what is commonly known as a "tax-free" covenant clause.

The wording of these clauses differs in the various mortgages, the most common forms stating that the corporation agrees to pay the interest without deduction for any tax which it may be required to pay, or to reimburse the holder for any tax which he may be required to pay.

In the past the Treasury Department did not take official cognizance of the covenant. The tax was to be withheld and paid regardless of this clause, and the

adjustment of the tax liability was left to be settled by the corporation and the bondholder between themselves.

Under this ruling the burden of seeing that the corporation kept its covenant agreement was placed upon the individual bondholder. Corporations tried to break their covenants on various technical grounds. A number of cases have been decided with reference to the wording of such a clause as will hold the corporation liable.

The amendments of October 3, 1917, give recognition to these "tax-free" covenants by providing that the tax on interest accruing to citizens or residents of the United States on bonds of domestic corporations should be withheld at the source only if the bonds contained a "tax-free" covenant.

This withholding applies *only* if the corporation is willing to live up to its covenant.

This fact is brought out in a ruling in which it is stated that the *issuing corporation,* and not the bank by whose agency collection is made, will be required to withhold the tax on the interest on those bonds containing the "tax-free covenant" clause.[1]

This leaves the decision as to whether the tax should be withheld entirely to the discretion of the issuing corporation. The government does not attempt to say what is, or what is not a tax-free covenant. If the corporation pays the tax it thereby admits that the bond does contain a tax-free covenant, and must therefore pay the bondholder the full interest without any deduction for the tax. On the other hand, if the corporation does not pay the tax, the bondholder cannot claim any credit for tax paid at the source, and will therefore have to pay the tax himself. If the bondholder believes that the bond contains a tax-free clause under which the corpora-

[1] If the Government had not issued this decision it would have placed the burden of deciding whether or not any certain bonds contained a tax free clause upon itself.

tion should have paid the tax, he may sue the corporation for breach of its covenant.

The Government's point of view is that there are really two transactions in connection with the payment of the tax on bonds containing the tax-free clause. The corporation withholds the tax on the coupon, paying over to the holder the face amount of the coupon, less the tax. In compliance with its covenant the corporation then reimburse the holder for the amount of the tax.

In practice there is only one transaction. The corporation pays the full amount of the coupon to the bondholder, and then pays the tax due out of its own funds.

In connection therewith the Treasury Department stated:

"The stipulation whereby a corporation agrees to pay the tax on interest from bonds is a matter which concerns only the bondholder and the corporation issuing the bonds. The government is concerned only with the deducting and the withholding of the tax, and the question of the amount to be paid to the bondholder is left for adjustment between him and the debtor corporation."

Duty of the withholding bank in paying interest coupons.—It is the custom of most corporations to appoint a certain bank as their paying agent. This bank acts as agent for the corporation, withholding the tax when necessary and making the return as a withholding agent.

The local bank with which the coupon is deposited acts only as the collecting agent of the depositor and is not charged with any duties as to withholding. The local bank may credit its depositor with the face amount of the coupon, but such credit is only a courtesy upon the part of the bank, and is subject to a charge for any tax which may be withheld at the source.

As stated above, the bank is not charged with deciding whether or not the bond contains a tax-free clause, and

the withholding of any tax because of a tax-free covenant should be decided by the issuing corporation.

The duty of the bank is to withhold 2 per cent on interest accruing to non-resident alien individuals and 6 per cent on interest accruing to non-resident alien corporations.

To protect itself the paying bank should withhold at the rate of 6 per cent, unless the interest coupon is accompanied by an ownership certificate on the proper form showing that the owner is not subject to withholding at all, or is subject to withholding only at the rate of 2 per cent. These ownership certificates are turned over to the collector of internal revenue, together with the withholding return Form 1012, and should be filed with the collector within 20 days following the month for which the payment is made.

An annual report is also required on or before March 1, of the following year, from the withholding agent, which report is a recapitulation of the monthly reports, and from the former the assessment of the tax against the withholding agent is made.

When the amendments were enacted, October 3, 1917, it was not clear whether the withholding from non-resident alien corporations was meant to be at the rate of 2 per cent or at the rate of 6 per cent, and a number of banks withheld only at the 2 per cent rate. They are, therefore, now liable for the difference between 6 per cent and 2 per cent on all interest items paid to non-resident alien corporations on and after Oct. 4, 1917.

Whether or not the bank should pay over the full amount of the coupon to the holder in the case of tax-free covenant bonds depends upon the instructions given by the issuing corporation. As stated before, if the corporation wishes to keep its covenant it must pay the bondholder the full amount of interest without any deduction for the tax.

In all cases where individuals or fiduciaries own

bonds containing the tax-free covenant clause, they should execute the proper certificate (form 1000) showing ownership of the bond and coupon, and thereby not claiming exemption. This will then put the matter of accounting for the tax clearly up to the debtor corporation, which must assume the payment of the tax or else violate its bond covenant.

Debtor corporations or their paying agents, in the case of bonds not containing the tax-free clause, must still require the recipients of the interest, if they are citizens or residents of the United States, to execute ownership certificate form 1001, but such corporations or agents will not be required to withhold or to list individually such payments on the monthly report form 1012, but simply show the total number and amount of such certificates on the last line of form 1012 and forward the ownership certificate and form 1012 with a letter of transmittal to the collector of internal revenue on or before the 20th day of the month following that in which such payments were made. Of course, in the case of payment of interest on such bonds to non-resident alien individuals, the tax should be withheld at the rate of 2 per cent and, in the case of non-resident aliens corporations, at the rate of 6 per cent.

Withholding on dividends on the stock of domestic corporations.—Withholding on dividends on stock of domestic corporations applies only when the income accrues to non-resident alien corporations. The withholding will be at the rate of 2 per cent, which is the same rate as that which the corporation would have to pay on dividends from domestic corporations.

Situations arising in cases where the record owner is not the actual owner are to be handled in a manner similar to that of the handling of situations arising in cases in which registered bonds are concerned (p. 264).

Form 1000.
Revised January, 1918.
U. S. INTERNAL REVENUE.

OWNERSHIP CERTIFICATE—TAX TO BE PAID AT SOURCE

INTEREST ON BONDS OF DOMESTIC AND RESIDENT CORPORATIONS

Names must be printed or written plainly.

DEBTOR ORGANIZATION

Name..

Address...

....

OWNER OF BONDS (Give name in full)

Name..

Address...

....

I CERTIFY that the owner of the bonds from which the interest entered herein was derived falls within the class of persons or organizations opposite which such interest is entered, and that exemption is not claimed from having the normal tax paid at the source on the amount of interest reported.

Signature of owner or agent

....

Address of agent. ....
....

This form must be used by debtor organizations to report payments of interest on registered bonds when such payments are not covered by ownership certificates made by owners of bonds. When so used, the form need not be signed, but must bear the name and address of the debtor organization.

If payee is an individual, is he married?........................ If not, is he head of a family?........................

OWNER	INTEREST ON BONDS—	AMOUNT		
Citizen or Resident of United States: 1 Individual or fiduciary*..............	Containing tax-free-covenant clauses (personal exemption not claimed)................	$......	....	.....
Nonresident Alien: 2 Individual or fiduciary*..............	Whether or not containing tax-free-covenant clauses.........	$......	....	.....
3 Corporation having no office or place of business in the United States..........	Whether or not containing tax-free-covenant clauses.........	$......	....	.....
Unknown: 4 †Coupons received not accompanied by ownership certificates (see note below)..	Whether or not containing tax-free-covenant clauses.........	$......	....	.....

*Fiduciaries must enter under "Owner of Bonds" the name of estate, trust, or beneficiary on behalf of whom this certificate is made. If bonds are owned jointly, separate forms must be used by each joint owner.

†If owner of bonds is unknown, certificate must be made by first bank which will enter amount of interest on line 4 and name and address of payee in space provided for "Owner of Bonds," striking out the word "Owner" and inserting "Payee."

Treasury Decision 2452 follows:

When a non-resident alien record owner of stock of domestic or resident corporations is an organization subject to withholding at the source of dividend payments, as provided by section 13(f) of the act of September 8, 1916, but is not the actual owner of the stock, such record owner may adapt income tax certificate Form 1087, to disclose actual ownership and to claim exemptions from withholding by striking out the words "to be filed with representative in the United States of such Foreign Principal" in the caption and the words "in the United States" in the body of the form and executing the certificate as the representative of the actual owner, as provided in the space for signature.

Thus modified, certificates Form 1087 may be filed, under the penalties prescribed for misrepresentation, with debtor corporations or their withholding agents in the United States and may be accepted by them as evidence that the record owner is not liable for income tax on the dividends to be paid and hence is not subject to having tax withheld.

If the record owner does not exercise his right to disclose actual ownership for the purpose of claiming exemption from having tax withheld at the source, debtor corporations and their withholding agents in the United States will be held liable on their stock records of ownership for the tax required to be withheld by section 13(f) of the act of September 8, 1916.

In the absence of a disclosure of actual ownership filed with debtor corporations or their withholding agents on certificate Form 1087, the normal tax required to be withheld in accordance with stock records of ownership can only be released to a record owner not liable for tax, upon a proper showing to the Commissioner of Internal Revenue of record and actual ownership, the names and post-office addresses of debtor corporations and withholding agents, and the amounts withheld.

As a record owner is held to be "the proper representative having the receipt, custody, control or disposal" (Sec. 9(*g*), act of September 8, 1916) of income of the actual owner, this showing should be made by means of a return by or in behalf of the actual owner when the actual owner is liable for a return under the provisions of law.

When a return is not required to be filed by or in behalf of the actual owners, the showing may be made upon the certification of the record owner.

Upon the showing thus made, either by certification or return, as the circumstances may require, the Commissioner of Internal Revenue will make such assessments and issue such instructions to debtors and withholding agents as will insure the proper collection of tax in accordance with the respective actual tax liabilities.

The law does not provide any method for withholding the tax on dividends paid in stock of the corporation. The safest procedure for the issuing corporation to follow would be to require the foreign stockholder to de-

posit an amount of money sufficient to cover the tax required to be withheld, before turning over the certificates for the new shares.

Withholding on miscellaneous incomes.—The withholding of the tax on miscellaneous income should be at the rates of 2 per cent on income accruing to non-resident alien individuals and 6 per cent to non-resident alien corporations.

This would include any royalties, disposition of profits (other than dividends), interest on bank deposits, commissions, or any other income that was actually determinable.

It would also include that income paid by a fiduciary or executor of an estate where the beneficiary was a non-resident alien.

Claims for deduction allowed non-residents.—No claims for the specific exemptions of $3,000 or $4,000 allowed under the 1916 law will be allowed non-resident claims, as these exemptions have been eliminated in the amended law. (Section 7, subdivision (b).) The non-resident alien may, however, file with the withholding agent a claim for the benefit of known deductions allowable on or before Feb. 1.

Refund to non-residents for excess taxes withheld at the source.—In cases of excess taxes withheld at the source from non-resident aliens such non-resident aliens should file with the collector of internal revenue at Baltimore, Md., on or before March 1, a true and accurate return of total income from sources within the United States and attach to such return a complete statement clearly setting forth the names and addresses of the withholding agents, and the districts wherein their withholding reports were filed, so that proper adjustment may be made in order that correct assessment may be made against the withholding agent, and the difference then refunded by such withholding agent to the non-resident alien. If such report cannot be filed within

Form 1001.
Revised January, 1918.
U. S. INTERNAL REVENUE.

OWNERSHIP CERTIFICATE—TAX NOT TO BE PAID AT SOURCE

INTEREST ON BONDS OF DOMESTIC AND RESIDENT CORPORATIONS

Names must be printed or written plainly.

DEBTOR ORGANIZATION	OWNER OF BONDS (Give name in full)
Name....................	Name....................
Address....................	Address....................
....	....

I CERTIFY that the owner of the bonds from which the interest entered herein was derived falls within the class of persons or organizations opposite which such interest is entered and is entitled to the interest reported without deduction of any tax.

Signature of owner or agent.

....

Address of agent. ....
....

If the interest on bonds containing tax-free-covenant clauses received by a citizen or resident individual or fiduciary exceeds the amount of exemption he desires to claim, such excess should be reported on Form 1000.

If owner is an individual, is he married?........ If not, is he head of a family?........

OWNER	INTEREST ON BONDS—	AMOUNT		
Citizen or Resident of United States:				
1 Individual or fiduciary*..........	Containing tax-free-covenant clauses (personal exemption claimed)..........	$.....	.....	.....
2 Individual or fiduciary*..........	Not containing tax-free-covenant clauses (not subject to withholding)..........	$.....	.....	.....
3 Partnership, corporation, or association.	Whether or not containing tax-free-covenant clauses (not subject to withholding).......	$.....	.....	.....
Nonresident Alien:				
4 Partnership..........	Whether or not containing tax-free-covenant clauses (not subject to withholding).......	$.....	.....	.....
5 Corporation having an office or place of business in the United States........	Whether or not containing tax-free-covenant clauses (not subject to witholding)........	$.....	.....	.....

*Fiduciaries must enter under "Owner of Bonds" the name of estate, trust, or beneficiary on behalf of whom exemption is claimed. If bonds are owned jointly, separate forms must be used by each joint owner.

that time, and the total tax is withheld and paid by the withholding agent, the non-resident alien should make claim for refund on Form 46, and attach to such form a copy of his true and actual return of net income.

A State, county, municipality or any other political subdivision of a State is not required to withhold any amount of income tax from interest which it may pay upon its own obligations, even though such interest is paid to non-resident alien individuals or to foreign corporations.

Reports required of withholding corporations.—Debtor corporations withholding any amount of income tax from interest on "tax-free" obligations paid to citizens or residents of the United States, are required to report such payments, on the prescribed form (Form 1012), to the collectors for their districts within twenty days after the close of the month during which the tax was withheld. This ruling is also applicable to any payments of interest made on corporate obligations, whether "tax-free" or not, made to non-resident alien individuals, foreign corporations, joint stock companies, etc., having no office or place of business in the United States.

A return of the amount of tax withheld from payments of fixed and determinable gains, profits or income made to non-resident alien individuals, other than interest on corporate obligations, by individuals, citizens or residents of the United States, domestic or resident corporations, joint stock companies, etc., is not required until after the close of the year during which the tax was withheld, but such returns are not to be filed later than March 1 of the next succeeding year on forms 1042 and 1098.

The amount of tax assessed against such withholding returns as are rendered is to be paid by the withholding agent to the collector of internal revenue for the district, after receipt from the collector of a notice of the amount assessed and demand therefor.

Release of tax heretofore, but not now, required to be withheld.—Section 1212 of the act of October 3, 1917, provides that any amount heretofore withheld by any withholding agent, as required by Title I of the act of September 8, 1916, on account of the tax imposed upon the income of any individual, a citizen or resident of the United States, for the calendar year of 1917, except that withheld from interest paid on bonds containing a "tax-free" or "no-deduction" clause, shall be released and paid over to such individual.

Therefore, any amount of normal tax withheld during the year 1917 from income paid to a citizen or resident of the United States, including income withheld on salary paid to officers and employees of a corporation or firm, except interest on bonds and mortgages or deeds of trust, or other similar obligations of corporations, joint stock companies, etc., containing a so-called "tax-free" or "no-deduction" clause, may now be released and paid over to such individual, and no return or payment of such tax will be required from the withholding agent.

In a case where a bank or other collection agency detached the ownership certificate which accompanied an interest coupon and substituted its own certificate, Form 1059, which did not disclose the name and address of the bond owner, it is held that where substitute certificate, Form 1059, has been used in connection with coupons from bonds which do not contain a "tax-free" or "no deduction" clause, the withholding agent shall request the bank or collection agency to disclose the name and address of the owner of the bond, as shown by the original certificate, and it shall be the duty of the bank or collection agency to make such disclosure to the withholding agent. If the owner of the bond is a citizen or resident of the United States, the withholding agent shall refund the amount of tax deducted, as provided by law, and if a non-resident alien,

no refundment shall be made, but the withholding agent shall make return thereof on or before March first, and on or before the time fixed by law for the payment of the tax shall pay the amount withheld to the Auditor of the United States Government authorized to receive the same. (T. D. 2635.)

In lieu of withholding at the source on salaries and other fixed and determined annual income paid to individuals, the law now provides for an elaborate system of information at the source.

INFORMATION AT THE SOURCE

Returns of information.—Section 26 of the act of September 8, 1916, as amended, provides that every corporation, joint-stock company or association or insurance company subject to the Federal Income Tax on its own income, shall, when required by the Commissioner of Internal Revenue, render a correct return on form 1096, duly verified under oath, of its payments of dividends, whether made in cash or its equivalent or in stock, which return shall give the names and addresses of the stockholders, the number of shares owned by each, the aggregate amount of dividends received by each, and the tax years and the applicable amounts in which such dividends were earned.[1]

Section 27 provides that every person, corporation, partnership or association, doing business as a broker on any exchange or board of trade or other similar place of business shall, when required by the Commissioner of Internal Revenue, render a correct return on form 1096, duly verified under oath, showing the names and addresses of customers for whom any business has been transacted, with such details as to profits, losses or other information which the Commissioner of Internal Revenue may require to enable him to

[1] For the present the commissioner will not require this information. (*Letter dated February* 14, 1918.)

determine whether all income tax due on profits or gains of such customers has been paid.[1]

Section 28 provides that all persons, corporations, partnerships, associations and insurance companies, making a payment to any person, corporation, partnership, association or insurance company, of interest, rent, salaries, wages, premiums, or other items of fixed and determinable gains, profits and income (other than dividends on stocks or gains or profits derived from transactions on any exchange or board of trade, or other similar place of business) of $800 or more during any calendar year, shall render a true and accurate return on forms 1096 and 1099 covering the payments made, which return shall disclose the names and addresses of the recipients of such payments and the aggregate amount paid to each during the calendar year.

This report must show the name of the recipient of the income, the address, and the total income paid during the year.

A return is not required to be filed where an individual is paid merely at a rate equal to or in excess of $800 a year, if the entire amount actually paid to him within the year did not equal or exceed $800.

It does not matter, for the purpose of the tax, in what form an individual is paid, whether his income is fixed or not, whether he receives wages or is paid on a piece-work basis; if his total income from a single payor during the year equalled $800, such payor must file a return. A return of information at the source is required, moreover, if the cash compensation paid, plus any commissions, living expenses, or other allowances, in the aggregate amount exceeds $800 for the tax year.

This requirement also attaches to fiduciaries paying any beneficiary to an estate income of $800 or more during the year (see chapter on *Fiduciaries*).

[1] For the present the commissioner will not require this information. (*Letter dated February* 14, 1918.)

Returns of information will also be required, regardless of amounts paid, in the case of payments of interest upon bonds and mortgages or deeds of trust or other similar obligations of corporations, joint-stock companies, associations and insurance companies and, also, in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon bonds and dividends from the stock of foreign corporations, from all persons, corporations, partnerships or associations which undertake as a matter of business or profit the collection of foreign payments of interest or dividends by means of coupons, checks or bills of exchange on forms 1096 and 1099.

Such certificates or forms are not required to be filed nor such information given by the paying bank regarding the payment of interest on either the 3½ per cent or the 4 per cent Liberty Bonds when interest coupons are presented for collection.

Payment to agent.—When an agent receives, in behalf of his principal, a payment falling within the provision of the law for information at the source, the agent is required by law to furnish the name and address of the principal upon receipt of a demand therefor from the payor. If the agent refuses to comply with this demand he becomes liable for a penalty of not less than $20 nor more than $1,000.

License for collecting foreign income.—Under the provisions of section 9 of the act of September 8, 1916, as amended, no person, corporation, partnership or association can undertake as a matter of business or for profit the collection of foreign payments of interest or dividends by means of coupons, checks or bills of exchange without first obtaining a license from the Commissioner of Internal Revenue, and whoever knowingly undertakes to collect such payments, as aforesaid, without having obtained a license therefor, or without complying with prescribed regulations, shall be deemed

guilty of a misdemeanor and for each offense be fined in a sum not exceeding $5,000, or imprisoned for a term not exceeding one year, or both, in the discretion of the court.

Those who had obtained such a license under the act of October 3, 1913, or under the Act of September 8, 1916, are not required to take out a new license, as it is held that such licenses previously obtained under either of those acts fully meet this requirement.

The time for filing returns for information at the source has been extended for 1917 reports until April 1, 1918.

CHAPTER XII

FIDUCIARIES

WHO ARE FIDUCIARIES

"Fiduciaries" defined.—For the purpose of the Income Tax law, the term "fiduciaries" includes "guardians, trustees, executors, administrators, receivers, conservators and all persons, corporations, or associations, acting in any fiduciary capacity." A fiduciary capacity is that in which a person holds the legal title to an estate in which another person, known as the beneficiary, has the beneficial interest. The beneficiary, as well as the fiduciary, may be either an individual or a corporation or other organization. Where the fiduciary is a corporation, it is for all intents and purposes to regard itself as an individual fiduciary, that is, there are no separate forms for corporate and individual fiduciaries.

Classes of fiduciaries.—The following paragraphs give brief definitions of the classes of fiduciaries, within the meaning of the term as used in the Income Tax law.

Guardian.—A legal guardian (in whom is vested legal title to an estate for the benefit of a minor, whether or not he is the parent of the minor child) is a fiduciary, but a natural guardian, as such, is not. The guardian of an insane or otherwise incompetent person comes under the first classification.

Trustee.—A trustee is a person who holds the legal title to an estate, and as such has the right to control it, though the beneficial interest belongs to another person. Trustees of individuals in bankruptcy are fiduciaries; those of corporations are not, that is, the trustees or

receivers of corporations in bankruptcy report on the forms used for corporations and can know how to fill out their returns if they look upon themselves as agents for the corporation.

Executor.—An executor is one who gets title to the personal estate of a decedent by virtue of an appointment in the latter's will and a confirmation of that appointment by the proper judicial officer, such as a surrogate or judge of a probate or orphans' court. After an executor has converted an estate into money, ascertained its exact amount, paid debts and specified legacies he may continue to hold some of the property under a direction contained in the will as trustee for named beneficiaries.

Administrator.—An administrator is one who gets title to the personal estate of a decedent by virtue of an appointment by a court charged with the administration of the estate. Thus executors are appointed in a will and administrators are appointed where there is no will, or where the will makes no nomination or where the person named in the will fails to qualify.

Receiver.—A receiver is an impartial person appointed by a court of equity to hold property, pending the termination of litigation with respect to the property. The receiver is "the right arm of the court" and his holding of the property in effect puts the control of the property in the hands of the court itself. The receiver for an individual is classed as a fiduciary—but the receiver for a corporation, joint-stock company, association or insurance company is not. The receivers for such organizations report their income on the corporate forms.

Conservator.—Conservators are persons designated by law to hold property pending its ultimate disposition by virtue of some provision of the law. They are ordinarily charged with no active duties respecting the estate beyond doing what is necessary to conserve it.

Agent not a fiduciary.—Since a fiduciary must be one who holds legal title for the benefit of a cestui que trust, an agent acting only under a power of attorney is not a fiduciary, within the meaning of the Income Tax law, whatever may be his authority as to management and distribution of the estate or income of his principal.

Receivers, trustees in bankruptcy and assignees of corporations etc., are not fiduciaries.—A receiver, trustee in bankruptcy, or assignee of a corporation, joint-stock company or association or insurance company, as we have seen, is not a fiduciary, but an agent, and is required to render regular returns of corporate income in the same manner and form as would the officers of the corporation were they themselves operating its business.

Receivers, etc., for individuals are fiduciaries.—The foregoing paragraph applies only to corporations and other organizations as specified therein, and not to individuals. Receivers, trustees and assignees of individuals are fiduciaries, for the purpose of the tax.

Who are beneficiaries.—Any person entitled to an interest in the estate held by a fiduciary is said to be a beneficiary. Thus legatees, heirs, wards, creditors of bankrupt individuals are all looked upon as beneficiaries and even the estate itself is to be regarded a beneficiary in respect to income received during the year and undistributed.

WHAT REPORTS MUST BE FILED BY FIDUCIARIES

Fiduciaries act for and are subject to provisions applying to individuals.—In general, fiduciaries are required to "make and render a return of the income of the person, trust, or estate for whom or which they act, and be subject to all the provisions of this title which apply to individuals." They must file (1) reports of information at the source and (2) reports of taxable

income on Forms 1040 or 1041, as explained in the following sections.

Report of information at the source.—If the income paid by a fiduciary to a beneficiary amounts during a calendar year to $800 or more, he must file a return of information at the source at such time and in such manner as may be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury.

This report is not a report of income received by the fiduciary, but a report of money paid over to the beneficiary and is a counterpart of the report required of any person who pays money in excess of or equal to $800 to another when the money paid is considered income by the latter. See preceding chapter on "Withholding," etc., at the Source."

No report required if only corpus of estate is distributed.—Income paid to beneficiaries must be reported under the conditions mentioned above, but if the amounts paid to the beneficiary are a distribution of only the principal or corpus of the estate, no report is required.

Report when income from estate is distributed annually.—In the case of estates the income of which is distributed annually, if the amount paid during the calendar year to any one beneficiary is in excess of the specific exemption allowed to that beneficiary, $1,000 or $2,000 as the case may be, the fiduciary is required to file a return on Form 1041, that is, if there is among the beneficiaries one or more receiving an amount in excess of the specific exemption, so that the income tax would apply, the return must be filed on Form 1041, and on this return must be shown not only the amounts paid to the taxable beneficiary, but also all amounts paid to all other beneficiaries.

Fiduciary to pay tax on income of decedent earned prior to his death.—If the net income of a decedent from January 1, of the year during which he died to the date

of his death equalled or exceeded, in the case of an unmarried person, $1,000, and in the case of a married person, $2,000, the fiduciary should file a return on Form 1040 on behalf of such decedent, and pay the tax indicated to be due by such return, and if the income of the decedent's estate for the remainder of the calendar year equals or exceeds $1,000 and the estate is not settled and distributed by December 31st of that year, the fiduciary will be required to file a return (Form 1040) on behalf of the estate, and pay the taxes indicated thereon to be due.

Taxes to be paid by fiduciary on income of minors, insane persons and non-resident alien beneficiaries.—The fiduciary, as we have seen, is required by law to make out the returns for minors, insane persons and non-resident alien beneficiaries for whom he acts. The law also requires the fiduciary in such cases to pay the taxes, both normal and additional. An exception exists in the case where a minor becomes of age during the calendar year for which the income is being reported. In such cases the fiduciary makes a report for the period during which he acted, and the minor also makes a report which includes also the income received through the fiduciary.

Report of income of trust estate.—Whenever the income of a trust estate (that is, an estate which receives its own income, as when the income, instead of being distributed to beneficiaries, is held in trust or put back or added to the corpus of the estate) equals or exceeds $1,000, (the specific exemption allowed to estates) the fiduciary must file a return of income on Form 1040, and pay all the taxes and supertaxes due thereon.

In cases where part of the income is retained by the estate and the balance distributed to beneficiaries, the return is not required unless (1) the amount paid to a beneficiary or (2) the amount retained by the estate, equals or exceeds the specific exemption allowed respectively to the beneficiary or to the estate. If the amount

paid to any beneficiary equals or exceeds the specific exemption allowed him ($1,000 or $2,000 depending upon his status) the fiduciary must file a return on Form 1041, showing (1) the amounts paid to the beneficiary; (2) amounts paid to any other beneficiaries who may have received any sums whatsoever; (3) the amounts retained by the estate. If the income retained by the estate equals or exceeds $1,000, the fiduciary must file also a return on Form 1040, for the estate itself; that is, both returns are required when both the estate and any one or more of the beneficiaries are taxable.

Report of income of estate during period of settlement.—In the case of estates during period of administration or settlement, Form 1040 should be filed, and normal and supertaxes paid, if the net income during the calendar year equals or exceeds $1,000; the income, after the tax has been paid by the fiduciary, becomes part of the corpus of the estate, and when such income is later paid over to the beneficiaries of the estate it will be free from taxation in their hands.

If, however, the beneficiary knows what share he is entitled to, and reports such income himself, the fiduciary need not report it on Form 1040 but should report it on Form 1041. In such cases the estate is not taxed, but the amount of tax is based upon the individual's income, and when the income is later transferred to the beneficiary it is tax-exempt since it has already borne its share of the tax.

Beneficiaries not entitled to inspect fiduciary's return.—The beneficiaries of an estate are not entitled to the privilege of inspecting the returns filed by a fiduciary covering the estate in which they are interested, since the fiduciary is not subject to the control of the beneficiaries.

Fiduciary should render statement giving essential information to beneficiary.—However, a fiduciary distributing

annually income of an estate to a beneficiary should render to such beneficiary a statement apprising the beneficiary of the sources of the income so distributed, disclosing just what part of the amount distributed was received from dividends on stock of corporations which had already borne the income tax, what amount represents income already tax-paid at the source, and what income was not tax-paid at the source, in order that the beneficiary may be in a position properly to account for such income under the proper captions in his own personal return of income, on Form 1040.

If any part of the income distributed to the beneficiary is tax-exempt, such as income from public securities, property coming to the estate by gift, bequest, devise or descent, or if any portion of the corpus of the estate is distributed to the beneficiary, he should be informed of the fact by the fiduciary, in order that the beneficiary may omit such items from his tax return.

Report of income of decedent prior to his death.—If, during the year of a decedent's death, and prior to that event, his net income equalled or exceeded the exemptions allowed ($1,000 or $2,000, as the case might have been) the fiduciary must file a personal return on Form 1040, executed for and in behalf of the decedent as his agent; he must file also another return upon the same form (1040) for and in behalf of the estate, if it remains in process of administration and its net income from the date of the decedent's death until the end of the taxable year (December 31) equals or exceeds $1,000.

Reports of ancillary administrators.—An ancillary administrator is held to be merely the agent of the domiciliary administrator, and should transmit to his principal all information as to income received by him as such agent, in order that the domiciliary administrator may make a report covering the entire income of the estate.

Reports for foreign beneficiaries.—When there is only one beneficiary and he is a non-resident alien, the fidu-

ciary practically takes the place of the beneficiary and makes out the return for him on Form 1040. The fiduciary executes the report as the agent of the alien and reports the income of the estate as the income of the alien. Where there are two or more beneficiaries the fiduciary must file one return for the estate (Form 1041) and a separate return for each non-resident alien beneficiary (Form 1040). The fiduciary is required to account for and pay both the normal taxes and super-taxes shown thereon to be due.

Reports for minors and insane persons.—The fiduciary who acts for a single minor or insane beneficiary makes out a return for such minor or beneficiary on the form provided for individuals; he is not required to make out a return as fiduciary for the estate. Where, however, the fiduciary under one estate has more than one ward, he should file the fiduciary return on Form 1041, and a separate return on Form 1040 for each ward, if unmarried, whose income is at least $1,000, and if married, is at least $2,000. Fiduciaries are treated as the agents of wards and insane persons and are required to pay for their wards both normal and additional taxes out of the income in their control. The fiduciary, in filing returns for wards or other beneficiaries, should claim for and in behalf of the ward or beneficiary the specific exemptions to which the ward or beneficiary is entitled.

When a minor becomes of age, the fiduciary is required to render a return on Form 1041 stating such facts and showing the income for the period from the beginning of the year to the day when the minor becomes of age, and the quondam minor makes his separate return and includes all money received by him during the year from the guardian.

Reports where there are several trustees.—Where there is more than one trustee, one only need file the report. This is usually done by the person having direct charge of the estate. The fiduciary executing the report must

make oath that he has sufficient knowledge of the affairs of such person, trust, or estate to enable him to make the return.

WHERE AND WHEN TO FILE RETURN

Where report is filed.—The fiduciary, or the one of several fiduciaries, executing a return should file the return in the collection district where he resides or has his place of business. The residence of the beneficiaries is immaterial in determining this question.

When returns must be filed.—All returns required of fiduciaries must be filed on or before March 1, 1918, unless an extension of 30 days time is granted by the collector of internal revenue. Corporate trustees are governed by the same rules as apply to individuals and must report for the calendar year. Failure to file a return within the time prescribed subjects the fiduciary to the same penalties as are imposed upon an individual, excepting the penalty of the 50 per cent additional to the tax.

The tax is due and payable on or before June 15, and for failure to remit the tax within that time or within 10 days after notice and demand (Form 17) a 5 per cent penalty will be added, together with interest at the rate of 1 per cent per month.

CONTENTS OF REPORTS OF FIDUCIARY

Gross income.—Gross income consists of the income received by a fiduciary for the benefit of the estate. It will be remembered of course that the report is really being made *by the fiduciary* for the estate and everything included in the report for any estate is treated as though it were the sole income or outgo of the fiduciary as a fiduciary. In other words, the fiduciary should not confuse with the estate he is reporting, any income from transactions that pertain only to his own personal business or to that of other estates he may

represent. Where one person creates several separate estates with a single trustee, the trustee must make out separate returns for each of the several estates, even if the beneficiaries of the several estates are the same persons.

The gross income of an estate to be reported by fiduciaries is similar to that required to be reported by an individual, and will include all income derived from business, trade or sales; dealings in property, whether real or personal, which the estate may control or be interested in; rents received; and all interest received, whether from notes, mortgages or bank balances, and all interest from corporate obligations of domestic corporations. Interest received on obligations of foreign corporations should be separately reported, together with dividends on stock paid by foreign corporations having no place of business in the United States.

Distributive net interest in partnerships in which the estate may share should be reported under a separate caption, and income from royalties or any other miscellaneous income received should also be separately reported.

All dividends received by the estate from domestic corporations, or which have been received through other estates or through a partnership distribution of dividends on stock of domestic corporations held by the partnership should be grouped and shown separately, for the reason that such income has already borne its tax burden.

Interest on bonds or obligations of the United States (issued prior to September 1, 1917), or any of its possessions or of any State or political subdivision of a State, need not be reported.

Interest on Liberty 3½'s need not be reported, but interest on a total in excess of $5,000 par value of Liberty 4's, Treasury Certificates of Indebtedness and War Saving Certificates, must for the purpose of the

income tax be shown in the report when such a report is required to be filed.

Property received by the estate by way of gift, bequest or devise need not be reported, but income earned from such property must be reported.

Deductions from gross income in report filed by fiduciary.—Certain expenses may be incurred in the earning of income by an estate. These are allowable deductions from gross income, as are similar expenses incurred by individuals in the earning of their incomes. These expenses include such business expenses as wages, salaries, repairs and rentals.

Amounts paid for permanent improvements or betterments are capital expenses, and are not deductible.

Expenses of the administration of an estate, such as court costs, attorneys' fees, etc., are chargeable against the corpus of the estate before distribution to the beneficiaries, and therefore reduce the estate while it is still in the administrators' hands, hence they are not deductible from gross income in the income tax report.

With regard to executors' and administrators' commissions, it should be definitely ascertained by a fiduciary whether under State laws, under the terms of a will, or by the decree of a court, the commissions in question are deductible from the corpus of the estate, or from the income accruing to the beneficiaries of the estate. If the commissions are properly deductible from the corpus of the estate, they should not be deducted from gross income in the fiduciary's report. If, on the other hand, the commissions are to be deducted from the income of the estate distributable among the beneficiaries, the amount should be charged as a legitimate and necessary expense, properly deductible from the gross income of the estate.

Besides necessary expenses, there may be deducted from gross income all interest paid within the year,

except on indebtedness incurred in purchasing securities which are also deductible, excepting state inheritance and Federal Estate taxes, these being properly chargeable against the corpus of the estate.

Losses sustained during the year are allowable deductions if similar losses sustained by an individual would be deductible. (See Chapter on Individual Income Tax, Deductions.)

Debts past due and actually ascertained to be worthless and which did not become due until after the decedent's death, may be charged off if the amounts which they represent were included as income in a previous year's return of the fiduciary.

Debts due the decedent cannot be charged off under this caption, for the reason that those bad debts reduce the corpus of the estate. The only allowable bad debts deductible are those which the fiduciary included as income in the present or previous years. Such bad debts would be those which became due after the death of the decedent and which represent amounts which have been included by the fiduciary as income in previous or the current year's income tax returns; or debts which are represented by investments or loans made by the fiduciary after the creation of the estate or trust.

A reasonable amount for depreciation and depletion is allowable as a deduction from gross income. (See the discussion under Corporation Income Tax, Deductions, pp. 221-243.)

In the case of an estate the income of which is distributable annually to the beneficiaries or, in the case of a "trust" estate, where the terms of the will or trust or the decree of a court of competent jurisdiction provide for keeping the corpus of the estate intact, and when physical property forming a part of the corpus of the estate has suffered depreciation through its use or employment in business, a reasonable allowance for depreciation will be permitted, provided that a de-

preciation reserve representing the amount of such a deduction is set aside out of profits earned by the estate since the creation of the estate. Such depreciation allowance will not be deductible if no depreciation reserve is provided for out of profits, and the entire income is being paid annually to the beneficiaries.

Where fiduciaries include as a deduction an amount for depreciation, they should file with their return either (1) a copy of the provisions of the will, trust or decree requiring such depreciation deduction where any such provisions exist, or (2) a statement showing that actual depreciation occurs, that the amount thereof is that stated and that the funds or assets retained as a reserve against depreciation have been or will be preserved and applied as such, and not distributed to beneficiaries.

The purpose of these requirements is to prevent fiduciaries from including depreciation deductions in the returns they file for the estate when, actually, there is no depreciation reserve maintained, but the amounts claimed as a depreciation are in fact distributed to the beneficiaries.

WHO PAYS THE TAX

Withholding at the source against and by fiduciaries.— In respect to income due fiduciaries, income is treated the same as that due individuals. Fiduciaries who are citizens or who reside or have a place of residence here get their income for their estates without deduction at the source. Foreign non-resident fiduciaries must submit to the deduction of the income at the source and persons paying such income to them are liable for the tax in the same way as they are liable for the taxes on incomes due non-resident alien individuals.

The same rule applies to the income due from a fiduciary to a beneficiary. The former is not bound to make any deduction for the tax except in the case of non-resident alien individual beneficiaries.

When the beneficiary reports and pays the tax.—Where the beneficiary is neither a minor, nor an insane person nor a non-resident alien, he makes his own report and includes in it the income received from the fiduciary or credited to him by the fiduciary. In such case, of course, the beneficiary pays the tax himself.

When the fiduciary pays the tax.—The fiduciary, as we have seen, pays the tax and makes the return where his beneficiary is a minor or an insane person. He also pays the tax, normal and super, and makes a separate return for the income coming to the estate that is not credited to any definite beneficiary or that is accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests. Where income is accumulated for future distribution and is not credited to any beneficiary and is not reported by the beneficiary, it is to be treated as income coming into the hands of the fiduciary, to be reported by him. The taxes, normal and additional, are in such cases paid by the fiduciary, and the remaining income in such cases is looked upon thereafter as a part of the corpus of the estate not subject to taxation as income when it is transferred subsequently to the beneficiary.

Fiduciary to pay tax during period of settlement of the estate.—Taxes, normal and additional, are paid by the fiduciary on behalf of the estate on income received by estates of deceased persons, during the period of administration or settlement of the estate. But where the income is to be distributed annually or regularly and where the share of a beneficiary can be determined and is credited to such beneficiary, if the beneficiary keeps his books on an accrual basis he may report the income and pay the tax on his share in the same manner as though he had actually received it. Thus, if a legacy of $100,000 in bonds is left to *A* and the estate is quite certainly solvent, *A* may report the interest accruing on the bonds though the interest may be collected and

retained by the fiduciary and credited to the account of *A*. In such a case *A* would add the credited income to his own income and pay the normal taxes as well as the additional taxes which such an aggregate income would require.

A, of course, would follow this procedure where his aggregate net income is less than the aggregate income of the estate, since under such circumstances the tax rate would be lower on the income if credited to *A* and reported by him than if kept in the estate and reported by it.

"Income of estate or any kind of property held in trust, including such income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests and income held for future distribution under the terms of the will or trust" will be taxed as though it were the income of an individual and paid by the fiduciary. But where the income is to be distributed annually or regularly the amount of the tax is fixed with reference to each beneficiary's share, and paid by the beneficiary.

CHAPTER XIII

THE INCOME TAX LAW, AFFECTING INDIVIDUALS AND CORPORATIONS

TITLE I OF THE ACT OF SEPTEMBER 8, 1916 (39 STATS. AT LARGE 771); AS AMENDED BY THE ACT OF MARCH 3, 1917 (39 STATS. AT LARGE 1000), AND AS FURTHER AMENDED BY TITLE XII OF THE ACT OF OCTOBER 3, 1917 (PUBLIC—No. 50—65th CONGRESS)

TITLE I.—INCOME TAX

PART I.—ON INDIVIDUALS

Individual normal tax rate.—Sec. 1. (*a*) That there shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources by every individual, a citizen or resident of the United States, a tax of two per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources within the United States by every individual, a non-resident alien, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise.

Individual additional tax rate.—(*b*) In addition to the income tax imposed by subdivision (*a*) of this section (herein referred to as the normal tax) there shall be

levied, assessed, collected, and paid upon the total net income of every individual, or, in the case of a non-resident alien, the total net income received from all sources within the United States, an additional income tax (herein referred to as the additional tax) of one per centum per annum upon the amount by which such total net income exceeds $20,000 and does not exceed $40,000, two per centum per annum upon the amount by which such total net income exceeds $40,000 and does not exceed $60,000, three per centum per annum upon the amount by which such total net income exceeds $60,000 and does not exceed $80,000, four per centum per annum upon the amount by which such total net income exceeds $80,000 and does not exceed $100,000, five per centum per annum upon the amount by which such total net income exceeds $100,000 and does not exceed $150,000, six per centum per annum upon the amount by which such total net income exceeds $150,000 and does not exceed $200,000, seven per centum per annum upon the amount by which such total net income exceeds $200,000 and does not exceed $250,000, eight per centum per annum upon the amount by which such total net income exceeds $250,000 and does not exceed $300,000, nine per centum per annum upon the amount by which such total net income exceeds $300,000 and does not exceed $500,000, ten per centum per annum upon the amount by which such total net income exceeds $500,000 and does not exceed $1,000,000, eleven per centum per annum upon the amount by which such total net income exceeds $1,000,000 and does not exceed $1,500,000, twelve per centum per annum upon the amount by which such total net income exceeds $1,500,000 and does not exceed $2,000,000, and thirteen per centum per annum upon the amount by which such total net income exceeds $2,000,000.

For the purpose of the additional tax there shall be included as income the income derived from dividends on the capital stock or from the net earnings of any cor-

poration, joint-stock company or association, or insurance company, except that in the case of non-resident aliens such income derived from sources without the United States shall not be included.

All the provisions of this title relating to the normal tax on individuals, so far as they are applicable and are not inconsistent with this subdivision and section three, shall apply to the imposition, levy, assessment, and collection of the additional tax imposed under this subdivision.

(*c*) The foregoing normal and additional tax rates shall apply to the entire net income, except as hereinafter provided, received by every taxable person in the calendar year nineteen hundred and sixteen and in each calendar year thereafter.

Individual income defined.—Sec. 2. (*a*) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, business, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

(*b*) Income received by estates of deceased persons during the period of administration or settlement of the estate, shall be subject to the normal and additional tax and taxed to their estates, and also such income of estates or any kind of property held in trust, including such income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests, and income held for future distribution under the terms of the will or trust shall be likewise

taxed, the tax in each instance, except when the income is returned for the purpose of the tax by the beneficiary, to be assessed to the executor, administrator, or trustee, as the case may be:

Provided, That where the income is to be distributed annually or regularly between existing heirs or legatees, or beneficiaries the rate of tax and method of computing the same shall be based in each case upon the amount of the individual share to be distributed.

Such trustees, executors, administrators, and other fiduciaries are hereby indemnified against the claims or demands of every beneficiary for all payments of taxes which they shall be required to make under the provisions of this title, and they shall have credit for the amount of such payments against the beneficiary or principal in any accounting which they make as such trustees or other fiduciaries.

(*c*) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived.

Additional tax includes undistributed profits.—Sec. 3. For the purpose of the additional tax, the taxable income of any individual shall include the share to which he would be entitled of the gains and profits, if divided or distributed, whether divided or distributed or not, of all corporations, joint-stock companies or associations, or insurance companies, however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided or distributed; and the fact that any such corporation, joint-stock company or association, or insurance company, is a mere holding company, or

that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a fraudulent purpose to escape such tax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax in such case unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner of Internal Revenue, or any district collector of internal revenue, such corporation, joint-stock company or association, or insurance company shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed.

Income exempt from law.—Sec. 4. The following income shall be exempt from the provisions of this title:

The proceeds of life insurance policies paid to individual beneficiaries upon the death of the insured; the amount received by the insured, as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract; the value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included as income); interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States (but, in the case of obligations of the United States issued after September first, nineteen hundred and seventeen, only if and to the extent provided in the Act authorizing the issue thereof) or its possessions or securities issued under the provisions of the Federal Farm Loan Act of July seventeenth, nineteen hundred and sixteen; the compensation of the present President of the United States during the term for which he has been

elected, and the judges of the supreme and inferior courts of the United States now in office, and the compensation of all officers and employees of a State, or any political subdivision thereof, except when such compensation is paid by the United States Government.

Deductions allowed.—Sec. 5. That in computing net income in the case of a citizen or resident of the United States—

(*a*) For the purpose of the tax there shall be allowed as deductions—

First. The necessary expenses actually paid in carrying on any business or trade, not including personal, living, or family expenses;

Second. All interest paid within the year on his indebtedness except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title;

Third. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes) or of its Territories, or possessions, or any foreign country, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits;

Fourth. Losses actually sustained during the year, incurred in his business or trade, or arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise: *Provided,* That for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained;

Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually

sustained therein during the year to an amount not exceeding the profits arising therefrom;

Sixth. Debts due to the taxpayer actually ascertained to be worthless and charged off within the year;

Seventh. A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;

Eighth. (*a*) In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (*b*) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (*a*) and (*b*) under rules and regulations to be prescribed by the Secretary of the Treasury:

Provided, That when the allowance authorized in (*a*) and (*b*) shall equal the capital originally invested, or in case of purchase made prior to March 1, 1913, the fair market value as of that date, no further allowance shall be made.

No deductions shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made;

Ninth. Contributions or gifts actually made within the year to corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or to societies for the prevention of cruelty to children or animals, no part of the net income of which inures to the benefit of any private stockholder or individual, to an amount not in excess

of fifteen per centum of the taxpayer's taxable net income as computed without the benefit of this paragraph. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury.

Credits allowed.—(*b*) For the purpose of the normal tax only, the income embraced in a personal return shall be credited with the amount received as dividends upon the stock or from the net earnings of any corporation, joint-stock company or association, trustee, or insurance company, which is taxable upon its net income as hereinafter provided;

(*c*) A like credit shall be allowed as to the amount of income, the normal tax upon which has been paid or withheld for payment at the source of the income under the provisions of this title.

Non-resident aliens—deductions and credits allowed.—Sec. 6. That in computing net income in the case of a non-resident alien—

(*a*) For the purpose of the tax there shall be allowed as deductions—

First. The necessary expenses actually paid in carrying on any business or trade conducted by him within the United States not including personal, living, or family expenses;

Second. The proportion of all interest paid within the year by such person on his indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) which the gross amount of his income for the year derived from sources within the United States bears to the gross amount of his income for the year derived from all sources within and without the United States, but this deduction shall be allowed only if such person includes in the return re-

quired by section eight all the information necessary for its calculation;

Third. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, paid within the United States, not including those assessed against local benefits;

Fourth. Losses actually sustained during the year, incurred in business or trade conducted by him within the United States, and losses of property within the United States arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise:

Provided, That for the purpose of ascertaining the amount of such loss or losses sustained in trade, or speculative transactions not in trade, from the same or any kind of property acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss or losses sustained;

Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profit arising therefrom in the United States;

Sixth. Debts arising in the course of business or trade conducted by him within the United States due to the taxpayer actually ascertained to be worthless and charged off within the year;

Seventh. A reasonable allowance for the exhaustion, wear and tear of property within the United States arising out of its use or employment in the business or trade;

(*a*) In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled

production or regular flow; (*b*) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (*a*) and (*b*) under rules and regulations to be prescribed by the Secretary of the Treasury:

Provided, That when the allowance authorized in (*a*) and (*b*) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made. No deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made.

(*b*) There shall also be allowed the credits specified by subdivisions (*b*) and (*c*) of section five.

(*c*) A nonresident alien individual shall receive the benefit of the deductions and credits provided for in this section only by filing or causing to be filed with the collector of internal revenue a true and accurate return of his total income, received from all sources, corporate or otherwise, in the United States, in the manner prescribed by this title; and in case of his failure to file such return the collector shall collect the tax on such income, and all property belonging to such nonresident alien individual shall be liable to distraint for the tax.

Personal exemption.—Sec. 7. That for the purpose of the normal tax only, there shall be allowed as an exemption in the nature of a deduction from the amount of the net income of each citizen or resident of the United States, ascertained as provided herein, the sum of $3,000, plus $1,000 additional if the person making the return

be a head of a family or a married man with a wife living with him, or plus the sum of $1,000 additional if the person making the return be a married woman with a husband living with her; but in no event shall this additional exemption of $1,000 be deducted by both a husband and a wife: *Provided,* That only one deduction of $4,000 shall be made from the aggregate income of both husband and wife when living together: *Provided further,* That if the person making the return is the head of a family there shall be an additional exemption of $200 for each child dependent upon such person, if under eighteen years of age, or if incapable of self-support because mentally or physically defective, but this provision shall operate only in the case of one parent in the same family: *Provided further,* That guardians or trustees shall be allowed to make this personal exemption as to income derived from the property of which such guardian or trustee has charge in favor of each ward or cestui que trust: *Provided further,* That in no event shall a ward or cestui que trust be allowed a greater personal exemption than as provided in this section, from the amount of net income received from all sources. There shall also be allowed an exemption from the amount of the net income of estates of deceased citizens or residents of the United States during the period of administration or settlement, and of trust or other estates of citizens or residents of the United States the income of which is not distributed annually or regularly under the provision of subdivision (*b*) of section two, the sum of $3,000, including such deductions as are allowed under section five.

Individual returns—Sec. 8. (*a*) The tax shall be computed upon the net income, as thus ascertained, of each person subject thereto, received in each preceding calendar year ending December thirty-first.

(*b*) On or before the first day of March, nineteen hundred and seventeen, and the first day of March in each

year thereafter, a true and accurate return under oath shall be made by each person of lawful age, except as hereinafter provided, having a net income of $3,000 or over for the taxable year, to the collector of internal revenue for the district in which such person has his legal residence or principal place of business, or if there be no legal residence or place of business in the United States, then with the collector of internal revenue at Baltimore, Maryland, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth specifically the gross amount of income from all separate sources, and from the total thereof deducting the aggregate items of allowances herein authorized:

Provided, That the Commissioner of Internal Revenue shall have authority to grant a reasonable extension of time, in meritorious cases, for filing returns of income by persons residing or traveling abroad who are required to make and file returns of income and who are unable to file said returns on or before March first of each year:

Provided further, That the aforesaid return may be made by an agent when by reason of illness, absence, or non-residence the person liable for said return is unable to make and render the same, the agent assuming the responsibility of making the return and incurring penalties provided for erroneous, false, or fraudulent return.

Returns of trustees and other fiduciaries.—(*c*) Guardians, trustees, executors, administrators, receivers, conservators, and all persons, corporations, or associations, acting in any fiduciary capacity, shall make and render a return of the income of the person, trust, or estate for whom or which they act, and be subject to all the provisions of this title which apply to individuals. Such fiduciary shall make oath that he has sufficient knowledge of the affairs of such person, trust, or estate to enable him to make such return and that the same is, to the best of his knowledge and belief, true and correct, and be sub-

ject to all the provisions of this title which apply to individuals:

Provided, That a return made by one of two or more joint fiduciaries filed in the district where such fiduciary resides, under such regulations as the Secretary of the Treasury may prescribe, shall be a sufficient compliance with the requirements of this paragraph:

Provided further, That no return of income not exceeding $3,000 shall be required except as in this title otherwise provided.

Returns of individual partners.—(*e*) Persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of the partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid under the provisions of this title:

Provided, That from the net distributive interests on which the individual members shall be liable for tax, normal and additional, there shall be excluded their proportionate shares received from interest on the obligations of a State or any political or taxing subdivision thereof, and upon the obligations of the United States (if and to the extent that it is provided in the Act authorizing the issue of such obligations of the United States that they are exempt from taxation), and its possessions, and that for the purpose of computing the normal tax there shall be allowed a credit, as provided by section five, subdivision (*b*), for their proportionate share of the profits derived from dividends. Such partnership, when requested by the Commissioner of Internal Revenue or any district collector, shall render a correct return of the earnings, profits, and income of the partnership, except income exempt under section four of this Act, setting forth the items of the gross income and the deductions and credits allowed by this title, and the names and addresses of the individuals who would be entitled to

the net earnings, profits, and income, if distributed. A partnership shall have the same privilege of fixing and making returns upon the basis of its own fiscal year as is accorded to corporations under this title. If a fiscal year ends during nineteen hundred and sixteen or a subsequent calendar year for which there is a rate of tax different from the rate for the preceding calendar year, then (1) the rate for such preceding calendar year shall apply to an amount of each partner's share of such partnership profits equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rate for the calendar year during which such fiscal year ends shall apply to the remainder.

(*f*) In every return shall be included the income derived from dividends on the capital stock or from the net earnings of any corporation, joint-stock company or association, or insurance company, except that in the case of non-resident aliens such income derived from sources without the United States shall not be included.

(*g*) An individual keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect his income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make his return upon the basis upon which his accounts are kept, in which case the tax shall be computed upon his income as so returned.

Assessment and administration.—Sec. 9. (*a*) That all assessments shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said amounts shall be paid on or before the fifteenth day of June, except in cases of refusal or neglect to make such return and in cases of erroneous, false, or fraudulent returns, in which cases the Commissioner of Internal

Revenue shall, upon the discovery thereof, at any time within three years after said return is due, or has been made, make a return upon information obtained as provided for in this title or by existing law, or require the necessary corrections to be made, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such person or persons immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the fifteenth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid, and interest at the rate of one per centum per month upon said tax from the time the same became due, except from the estates of insane, deceased, or insolvent persons.

Withholding of tax at the source.—(*b*) All persons, corporations, partnerships, associations, and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, receivers, conservators, employers, and all officers and employees of the United States, having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual or periodical gains, profits, and income of any nonresident alien individual, other than income derived from dividends on capital stock, or from the net earnings of a corporation, joint-stock company or association, or insurance company, which is taxable upon its net income as provided in this title, are hereby authorized and required to deduct and withhold from such annual or periodical gains, profits, and income such sum as will be sufficient to pay the normal tax imposed thereon by this title, and shall make return thereof on or before March first of each year and, on or before the time fixed by law for

the payment of the tax, shall pay the amount withheld to the officer of the United States Government authorized to receive the same; and they are each hereby made personally liable for such tax, and they are each hereby indemnified against every person, corporation, partnership, association, or insurance company, or demand whatsoever for all payments which they shall make in pursuance and by virtue of this title.

(*c*) The amount of the normal tax hereinbefore imposed shall also be deducted and withheld from fixed or determinable annual or periodical gains, profits and income derived from interest upon bonds and mortgages, or deeds of trust or other similar obligations of corporations, joint-stock companies, associations, and insurance companies (if such bonds, mortgages, or other obligations contain a contract or provision by which the obligee agrees to pay any portion of the tax imposed by this title upon the obligee or to reimburse the obligee for any portion of the tax or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon or to retain therefrom under any law of the United States) whether payable annually or at shorter or longer periods and whether such interest is payable to a nonresident alien individual or to an individual citizen or resident of the United States, subject to the provisions of the foregoing subdivision (*b*) of this section requiring the tax to be withheld at the source and deducted from annual income and returned and paid to the Government, unless the person entitled to receive such interest shall file with the withholding agent, on or before February first, a signed notice in writing claiming the benefit of an exemption under section seven of this title.

License required to collect foreign payments.—(*f*) All persons, corporations, partnerships, or associations, undertaking as a matter of business or for profit the collection of foreign payments of interest or dividends by

means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner of Internal Revenue, and shall be subject to such regulations enabling the Government to obtain the information required under this title, as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; and whoever knowingly undertakes to collect such payments as aforesaid without having obtained a license therefor, or without complying with such regulations, shall be deemed guilty of a misdemeanor and for each offense be fined in a sum not exceeding $5,000, or imprisoned for a term not exceeding one year, or both, in the discretion of the court.

Intent and purpose of tax.—(*g*) The tax herein imposed upon gains, profits, and incomes not falling under the foregoing and not returned and paid by virtue of the foregoing or as otherwise provided by law shall be assessed by personal return under rules and regulations to be prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury. The intent and purpose of this title is that all gains, profits, and income of a taxable class, as defined by this title, shall be charged and assessed with the corresponding tax, normal and additional, prescribed by this title, and said tax shall be paid by the owner of such income, or the proper representative having the receipt, custody, control, or disposal of the same. For the purpose of this ownership or liability shall be determined as of the year for which a return is required to be rendered.

The provisions of this section, except subdivision (*c*), relating to the deduction and payment of the tax at the source of income shall only apply to the normal tax hereinbefore imposed upon non-resident alien individuals.

PART II.—ON CORPORATIONS.

Rate of tax on corporations.—Sec. 10. (*a*) That there shall be levied, assessed, collected, and paid annually

upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized, but not including partnerships, a tax of two per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources within the United States by every corporation, joint-stock company or association, or insurance company, organized, authorized, or existing under the laws of any foreign country, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and including the income derived from dividends on capital stock or from net earnings of resident corporations, joint-stock companies or associations, or insurance companies, whose net income is taxable under this title.

The foregoing tax rate shall apply to the total net income received by every taxable corporation, joint-stock company or association, or insurance company in the calendar year nineteen hundred and sixteen and in each year thereafter, except that if it has fixed its own fiscal year under the provisions of existing law, the foregoing rate shall apply to the proportion of the total net income returned for the fiscal year ending prior to December thirty-first, nineteen hundred and sixteen, which the period between January first, nineteen hundred and sixteen, and the end of such fiscal year bears to the whole of such fiscal year, and the rate fixed in Section II of the Act approved October third, nineteen hundred and thirteen, entitled "An Act to reduce tariff duties and to provided revenue for the Government, and for other purposes," shall apply to the remaining portion of the total net income returned for such fiscal year.

For the purpose of ascertaining the gain derived or loss sustained, from the sale or other disposition by a

corporation, joint-stock company, or association, or insurance company, of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained.

Rate of tax on undistributed income.—(*b*) In addition to the income tax imposed by subdivision (*a*) of this section there shall be levied, assessed, collected, and paid annually an additional tax of ten per centum upon the amount, remaining undistributed six months after the end of each calendar or fiscal year, of the total net income of every corporation, joint-stock company or association, or insurance company, received during the year, as determined for the purposes of the tax imposed by such subdivision (*a*), but not including the amount of any income taxes paid by it within the year imposed by the authority of the United States.

The tax imposed by this subdivision shall not apply to that portion of such undistributed net income which is actually invested and employed in the business or is retained for employment in the reasonable requirements of the business or is invested in obligations of the United States issued after September first, nineteen hundred and seventeen: *Provided*, That if the Secretary of the Treasury ascertains and finds that any portion of such amount so retained at any time for employment in the business is not so employed or is not reasonably required in the business a tax of fifteen per centum shall be levied, assessed, collected, and paid thereon.

The foregoing tax rates shall apply to the undistributed net income received by every taxable corporation, joint-stock company or association, or insurance company in the calendar year nineteen hundred and seventeen and in each year thereafter, except that if it has fixed its own fiscal year under the provisions of existing law, the

foregoing rates shall apply to the proportion of the taxable undistributed net income returned for the fiscal year ending prior to December thirty-first, nineteen hundred and seventeen, which the period between January first, nineteen hundred and seventeen, and the end of such fiscal year bears to the whole of such fiscal year.

Conditional and other exemptions.—Sec. 11. (*a*) That there shall not be taxed under this title any income received by any—

First. Labor, agricultural, or horticultural organization;

Second. Mutual savings bank not having a capital stock represented by shares;

Third. Fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

Fourth. Domestic building and loan association and co-operative banks without capital stock organized and operated for mutual purposes and without profit;

Fifth. Cemetery company owned and operated exclusively for the benefit of its members.

Sixth. Corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual;

Seventh. Business league, chamber of commerce, or board of trade, not organized for profit and no part of the net income of which inures to the benefit of any private stockholder or individual;

Eighth. Civic league or organization not organized for profit but operated exclusively for the promotion of social welfare;

Ninth. Club organized and operated exclusively for

pleasure, recreation, and other non-profitable purposes, no part of the net income of which inures to the benefit of any private stockholder or member;

Tenth. Farmers' or other mutual hail, cyclone, or fire insurance company, mutual ditch or irrigation company, mutual or co-operative telephone company, or like organization of a purely local character, the income of which consists solely of assessments, dues and fees collected from members for the sole purpose of meeting its expenses;

Eleventh. Farmers', fruit growers', or like association, organized and operated as a sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;

Twelfth. Corporation or association organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title; or

Thirteenth. Federal land banks and national farm-loan associations as provided in section twenty-six of the Act approved July seventeenth, nineteen hundred and sixteen, entitled "An Act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes."

Fourteenth. Joint-stock land banks as to income derived from bonds or debentures of other joint-stock land banks or any Federal land bank belonging to such joint-stock land bank.

(*b*) There shall not be taxed under this title any income derived from any public utility or from the exercise

of any essential governmental function accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, nor any income accruing to the government of the Philippine Islands or Porto Rico, or of any political subdivision of the Philippine Islands or Porto Rico:

Provided, That whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, has, prior to the passage of this title, entered in good faith into a contract with any person or corporation, the object and purpose of which is to acquire, construct, operate, or maintain a public utility, no tax shall be levied under the provisions of this title upon the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, or the District of Columbia, or a political subdivision of a State or Territory; but this provision is not intended to confer upon such person or corporation any financial gain or exemption or to relieve such person or corporation from the payment of a tax as provided for in this title upon the part or portion of the said income to which such person or corporation shall be entitled under such contract.

Deductions allowed to corporations organized in United States.—Sec. 12. (*a*) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

Second. All losses actually sustained and charged off

within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;

(*a*) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow but by the settled production or regular flow;

(*b*) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (*a*) and (*b*) under rules and regulations to be prescribed by the Secretary of the Treasury:

Provided, That when the allowance authorized in (*a*) and (*b*) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; and

(*c*) in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts:

Provided, That no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made:

Provided further, That mutual fire and mutual employers' liability and mutual workmen's compensation and mutual casualty insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but

shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves:

Provided further, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof, and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year;

Third. The amount of interest paid within the year on its indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) to an amount of such indebtedness not in excess of the sum of (*a*) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock the entire amount of capital employed in the business at the close of the year, and (*b*) one-half of its interest-bearing indebtedness then outstanding:

Provided, That for the purpose of this title preferred capital stock shall not be considered interest-bearing indebtedness, and interest or dividends paid upon this stock shall not be deductible from gross income:

Provided further, That in cases wherein shares of capital stock are issued without par or nominal value, the amount of paid-up capital stock, within the meaning of this section, as represented by such shares, will be the

amount of cash, or its equivalent, paid or transferred to the corporation as a consideration for such shares:

Provided further, That in the case of indebtedness wholly secured by property collateral, tangible or intangible, the subject of sale or hypothecation in the ordinary business of such corporation, joint-stock company or association as a dealer only in the property constituting such collateral, or in loaning the funds thereby procured, the total interest paid by such corporation, company, or association within the year on any such indebtedness may be deducted as a part of its expenses of doing business, but interest on such indebtedness shall only be deductible on an amount of such indebtedness not in excess of the actual value of such property collateral:

Provided further, That in the case of bonds or other indebtedness, which have been issued with a guaranty that the interest payable thereon shall be free from taxation. no deduction for the payment of the tax herein imposed, or any other tax paid pursuant to such guaranty, shall be allowed; and in the case of a bank, banking association, loan or trust company, interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company shall be deducted;

Fourth. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or any foreign country, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits.

Deductions allowed to foreign corporations.—(*b*) In the case of a corporation, joint-stock company or association, or insurance company, organized, authorized, or existing under the laws of any foreign country, such net income shall be ascertained by deducting from the gross amount

of its income received within the year from all sources within the United States—

First. All the ordinary and necessary expenses actually paid within the year out of earnings in the maintenance and operation of its business and property within the United States, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

Second. All losses actually sustained within the year in business or trade conducted by it within the United States and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;

(*a*) and in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow;

(*b*) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (*a*) and (*b*) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*. That when the allowance authorized in (*a*) and (*b*) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; and

(*c*) in the case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided*, That no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or better-

ments, made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made: *Provided further,* That mutual fire and mutual employers' liability and mutual workmen's compensation and mutual casualty insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further,* That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment thereof and the payment thereof, and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of such individual policyholder, within such year;

Third. The amount of interest paid within the year on its indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) to an amount of such indebtedness not in excess of the proportion of the sum of (*a*) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of the capital employed in the business at the close of the year, and (*b*)

one-half of its interest-bearing indebtedness then outstanding, which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States: *Provided*, That in the case of bonds or other indebtedness which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed or any other tax paid pursuant to such guaranty shall be allowed; and in case of a bank, banking association, loan or trust company, or branch thereof, interest paid within the year on deposits by or on moneys received for investment from either citizens or residents of the United States and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company, or branch thereof;

Fourth. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, paid within the United States, not including those assessed against local benefits.

Guarantee or reserve funds of assessment insurance companies.—(*c*) In the case of assessment insurance companies, whether domestic or foreign, the actual deposit of sums with State or Territorial officers, pursuant to law, as additions to guarantee or reserve funds shall be treated as being payments required by law to reserve funds.

Corporation returns.—Sec. 13. (*a*) The tax shall be computed upon the net income, as thus ascertained, received within each preceding calendar year ending December thirty-first: *Provided*, That any corporation, joint-stock company or association, or insurance company, subject to this tax, may designate the last day of

any month in the year as the day of the closing of its fiscal year and shall be entitled to have the tax payable by it computed upon the basis of the net income ascertained as herein provided for the year ending on the day so designated in the year preceding the date of assessment instead of upon the basis of the net income for the calendar year preceding the date of assessment; and it shall give notice of the day it has thus designated as the closing of its fiscal year to the collector of the district in which its principal business office is located at any time not less than thirty days prior to the first day of March of the year in which its return would be filed if made upon the basis of the calendar year;

(b) Every corporation, joint-stock company or association, or insurance company, subject to the tax herein imposed, shall, on or before the first day of March, nineteen hundred and seventeen, and the first day of March in each year thereafter, or, if it has designated a fiscal year for the computation of its tax, then within sixty days after the close of such fiscal year ending prior to December thirty-first, nineteen hundred and sixteen, and the close of each such fiscal year thereafter, render a true and accurate return of its annual net income in the manner and form to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and containing such facts, data, and information as are appropriate and in the opinion of the commissioner necessary to determine the correctness of the net income returned and to carry out the provisions of this title.

The return shall be sworn to by the president, vice-president, or other principal officer, and by the treasurer or assistant treasurer.

The return shall be made to the collector of the district in which is located the principal office of the corporation, company, or association, where are kept its books of account and other data from which the return is prepared, or in the case of a foreign corporation, company, or as-

sociation, to the collector of the district in which is located its principal place of business in the United States, or if it have no principal place of business, office, or agency in the United States, then to the collector of internal revenue at Baltimore, Maryland.

All such returns shall as received be transmitted forthwith by the collector to the Commissioner of Internal Revenue;

(*c*) In case wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control;

(*d*) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned;

Withholding of tax at the source.—(*e*) All the provisions of this title relating to the tax authorized and required to be deducted and withheld and paid to the officer of the United States Government authorized to receive the same from the income of non-resident alien individuals from sources within the United States shall be made applicable

to the tax imposed by subdivision (*a*) of section ten upon incomes derived from interest upon bonds and mortgages or deeds of trust or similar obligations of domestic or other resident corporations, joint-stock companies or associations, and insurance companies by non-resident alien firms, co-partnerships, companies, corporations, joint-stock companies or associations, and insurance companies, not engaged in business or trade within the United States and not having any office or place of business therein;

(*f*) Likewise, all the provisions of this title relating to the tax authorized and required to be deducted and withheld and paid to the officer of the United States Government authorized to receive the same from the income of non-resident alien individuals from sources within the United States shall be made applicable to income derived from dividends upon the capital stock or from the net earnings of domestic or other resident corporations, joint-stock companies or associations, and insurance companies by non-resident alien companies, corporations, joint-stock companies or associations, and insurance companies not engaged in business or trade within the United States and not having any office or place of business therein.

Assessment and administration.—Sec. 14. (*a*) All assessments shall be made and the several corporations, joint-stock companies or associations, and insurance companies shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessment shall be paid on or before the fifteenth day of June:

Provided, That every corporation, joint-stock company or association, and insurance company, computing taxes upon the income of the fiscal year which it may designate in the manner hereinbefore provided, shall pay the taxes due under its assessment within one hundred and five days after the date upon which it is required to file its list or return of income for assessment; except in cases of re-

fusal or neglect to make such return, and in cases of erroneous, false, or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this title or by existing law; and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such corporation, joint-stock company or association, or insurance company immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the fifteenth day of June in any year, or after one hundred and five days from the date on which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due: *Provided*, That upon the examination of any return of income made pursuant to this title, the act of August fifth, nineteen hundred and nine, entitled, "An act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes," and the act of October third, nineteen hundred and thirteen, entitled, "An act to reduce tariff duties and to provide revenue for the Government, and for other purposes," if it shall appear that amounts of tax have been paid in excess of those properly due, the taxpayer shall be permitted to present a claim for refund thereof notwithstanding the provisions of section thirty-two hundred and twenty-eight of the Revised Statutes;

(*b*) When the assessment shall be made, as provided in this title, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such: *Provided,* That any and all such

returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President: *Provided further*, That the proper officers of any State imposing a general income tax may, upon the request of the governor thereof, have access to said returns or to an abstract thereof, showing the name and income of each such corporation, joint-stock company or association, or insurance company, at such times and in such manner as the Secretary of the Treasury may prescribe;

(*c*) If any of the corporations, joint-stock companies or associations, or insurance companies aforesaid shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint-stock company or association, or insurance company shall be liable to a penalty of not exceeding $10,000: *Provided*, That the Commissioner of Internal Revenue shall have authority, in the case of either corporations or individuals, to grant a reasonable extension of time in meritorious cases, as he may deem proper;

(*d*) That section thirty-two hundred and twenty-five of the Revised Statutes of the United States be, and the same is hereby, amended so as to read as follows:

"Sec. 3225. When a second assessment is made in case of any list, statement, or return, which in the opinion of the collector or deputy collector was false or fraudulent, or contained any understatement or undervaluation, no tax collected under such assessment shall be recovered by any suit unless it is proved that the said list, statement, or return was not false nor fraudulent and did not contain any understatement or undervaluation; but this section shall not apply to statements or returns made or to be made in good faith under the laws of the United States regarding annual depreciation of oil or gas wells and mines."

PART III.—GENERAL ADMINISTRATIVE PROVISIONS

Meaning of "States and United States."—Sec. 15. That the word "State" or "United States" when used in this title shall be construed to include any Territory, the District of Columbia, Porto Rico, and the Philippine Islands, when such construction is necessary to carry out its provisions.

General provisions.—Sec. 16. That sections thirty-one hundred and sixty-seven, thirty-one hundred and seventy-two, thirty-one hundred and seventy-three, and thirty-one hundred and seventy-six of the Revised Statutes of the United States as amended are hereby amended so as to read as follows:

"Sec. 3167. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or to make known in any manner whatever not provided by law to any person the operations, style of work, or apparatus of any manufacturer or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return, or to permit any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return or any part thereof or source of income, profits, losses, or expenditures appearing in any income return; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employee of the United States he shall be dismissed from office or discharged from employment."

"Sec. 3172. Every collector shall, from time to time,

cause his deputies to proceed through every part of his district and inquire after and concerning all persons therein who are liable to pay any internal-revenue tax, and all persons owning or having the care and management of any objects liable to pay any tax, and to make a list of such persons and enumerate said objects."

"Sec. 3173. It shall be the duty of any person, partnership, firm, association, or corporation, made liable to any duty, special tax, or other tax imposed by law, when not otherwise provided for, (1) in case of a special tax, on or before the thirty-first day of July in each year, (2) in case of income tax on or before the first day of March in each year, or on or before the last day of the sixty-day period next following the closing date of the fiscal year for which it makes a return of its income, and (3) in other cases before the day on which the taxes accrue, to make a list or return, verified by oath, to the collector or a deputy of the district where located, of the articles or objects, including the amount of annual income charged with a duty or tax, the quantity of goods, wares, and merchandise, made or sold and charged with a tax, the several rates and aggregate amount, according to the forms and regulations prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, for which such person, partnership, firm, association, or corporation is liable:

Provided, That if any person liable to pay any duty or tax, or owning, possessing, or having the care or management of property, goods, wares, and merchandise, articles or objects liable to pay any duty, tax, or license, shall fail to make and exhibit a list or return required by law, but shall consent to disclose the particulars of any and all the property, goods, wares, and merchandise, articles, and objects liable to pay any duty or tax, or any business or occupation liable to pay any tax as aforesaid, then, and in that case, it shall be the duty of the collector or deputy collector to make such list or return, which, being dis-

tinctly read, consented to, and signed and verified by oath by the person so owning, possessing, or having the care and management as aforesaid, may be received as the list of such person:

Provided further, That in case no annual list or return has been rendered by such person to the collector or deputy collector as required by law, and the person shall be absent from his or her residence or place of business at the time the collector or a deputy collector shall call for the annual list or return, it shall be the duty of such collector or deputy collector to leave at such place of residence or business, with some one of suitable age and discretion, if such be present, otherwise to deposit in the nearest post office, a note or memorandum addressed to such person, requiring him or her to render to such collector or deputy collector the list or return required by law within ten days from the date of such note or memorandum, verified by oath. And if any person, on being notified or required as aforesaid, shall refuse or neglect to render such list or return within the time required as aforesaid, or whenever any person who is required to deliver a monthly or other return of objects subject to tax fails to do so at the time required, or delivers any return which, in the opinion of the collector, is erroneous, false, or fraudulent, or contains any undervaluation or understatement, or refuses to allow any regularly authorized Government officer to examine the books of such person, firm, or corporation, it shall be lawful for the collector to summon such person, or any other person having possession, custody, or care of books of account containing entries relating to the business of such person, or any other person he may deem proper, to appear before him and produce such books at a time and place named in the summons, and to give testimony or answer interrogatories, under oath, respecting any objects or income liable to tax or the returns thereof. The collector may summon any person residing or found

within the State or Territory in which his district lies; and when the person intended to be summoned does not reside and can not be found within such State or Territory, he may enter any collection district where such person may be found and there make the examination herein authorized. And to this end he may there exercise all the authority which he might lawfully exercise in the district for which he was commissioned: *Provided,* That "person," as used in this section, shall be construed to include any corporation, joint-stock company or association, or insurance company when such construction is necessary to carry out its provisions."

"Sec. 3176. If any person, corporation, company, or association fails to make and file a return or list at the time prescribed by law, or makes, wilfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise. Any return or list so made and subscribed by a collector or deputy collector shall be prima facie good and sufficient for all legal purposes.

"If the failure to file a return or list is due to sickness or absence the collector may allow such further time, not exceeding thirty days, for making and filing the return or list as he deems proper.

"The Commissioner of Internal Revenue shall assess all taxes, other than stamp taxes, as to which returns or lists are so made by a collector or deputy collector. In case of any failure to make and file a return or list within the time prescribed by law or by the collector, the Commissioner of Internal Revenue shall add to the tax fifty per centum of its amount except that, when a return is voluntarily and without notice from the collector filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to wilful neglect, no such addition shall be made to the tax. In case a

false or fraudulent return or list is wilfully made, the Commissioner of Internal Revenue shall add to the tax one hundred per centum of its amount.

"The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax."

Sec. 17. That it shall be the duty of every collector of internal revenue, to whom any payment of any taxes is made under the provisions of this title, to give to the person making such payment a full written or printed receipt, expressing the amount paid and the particular account for which such payment was made; and whenever such payment is made such collector shall, if required, give a separate receipt for each tax paid by any debtor, on account of payments made to or to be made by him to separate creditors in such form that such debtor can conveniently produce the same separately to his several creditors in satisfaction of their respective demands to the amounts specified in such receipts; and such receipts shall be sufficient evidence in favor of such debtor to justify him in withholding the amount therein expressed from his next payment to his creditor; but such creditor may, upon giving to his debtor a full written receipt, acknowledging the payment to him of whatever sum may be actually paid, and accepting the amount of tax paid as aforesaid (specifying the same) as a further satisfaction of the debt to that amount, require the surrender to him of such collector's receipts.

Sec. 18. That any person, corporation, partnership, association, or insurance company, liable to pay the tax, to make a return or to supply information required under this title, who refuses or neglects to pay such tax, to make such return or to supply such information at the time or times herein specified in each year, shall be liable, except as otherwise specially provided in this title, to a penalty

of not less than $20 nor more than $1,000. Any individual or any officer of any corporation, partnership, association, or insurance company, required by law to make, render, sign, or verify any return or to supply any information, who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required by this title to be made, shall be guilty of a misdemeanor, and shall be fined not exceeding $2,000 or be imprisoned not exceeding one year, or both, in the discretion of the court, with the costs of prosecution; *Provided*, That where any tax heretofore due and payable has been duly paid by the taxpayer, it shall not be re-collected from any withholding agent required to retain it at its source, nor shall any penalty be imposed or collected in such cases from the taxpayer, or such withholding agent whose duty it was to retain it, for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

Sec. 19. The collector or deputy collector shall require every return to be verified by the oath of the party rendering it. If the collector or deputy collector have reason to believe that the amount of any income returned is understated, he shall give due notice to the person making the return to show cause why the amount of the return should not be increased, and upon proof of the amount understated may increase the same accordingly. Such person may furnish sworn testimony to prove any relevant facts, and, if dissatisfied with the decision of the collector, may appeal to the Commissioner of Internal Revenue for his decision under such rules of procedure as may be prescribed by regulation.

Sec. 20. That jurisdiction is hereby conferred upon the district courts of the United States for the district within which any person summoned under this title to appear to testify or to produce books shall reside, to compel such attendance, production of books, and testimony by appropriate process.

Sec. 21. That the preparation and publication of statistics reasonably available with respect to the operation of the income tax law and containing classifications of taxpayers and of income, the amounts allowed as deductions and exemptions, and any other facts deemed pertinent and valuable, shall be made annually by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury.

Sec. 22. That all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal revenue taxes not heretofore specifically repealed and not inconsistent with the provisions of this title, are hereby extended and made applicable to all the provisions of this title and to the tax herein imposed.

Sec. 23. That the provisions of this title shall extend to Porto Rico and the Philippine Islands: *Provided*, That the administration of the law and the collection of the taxes imposed in Porto Rico and the Philippine Islands shall be by the appropriate internal-revenue officers of those governments, and all revenues collected in Porto Rico and the Philippine Islands thereunder shall accrue intact to the general governments thereof, respectively: *Provided further*, That the jurisdiction in this title conferred upon the district courts of the United States shall, so far as the Philippine Islands are concerned, be vested in the courts of the first instance of said islands: *And provided further*, That nothing in this title shall be held to exclude from the computation of the net income the compensation paid any official by the governments of the District of Columbia, Porto Rico, and the Philippine Islands, or the political subdivisions thereof.

Sec. 24. That Section II of the Act approved October third, nineteen hundred and thirteen, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," is hereby repealed, except as herein otherwise provided, and except that it

shall remain in force for the assessment and collection of all taxes which have accrued thereunder, and for the imposition and collection of all penalties or forfeitures which have accrued or may accrue in relation to any of such taxes, and except that the unexpended balance of any appropriation heretofore made and now available for the administration of such section or any provision thereof shall be available for the administration of this title or the corresponding provision thereof.

Sec. 25. That income on which has been assessed the tax imposed by Section II of the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October third, nineteen hundred and thirteen, shall not be considered as income within the meaning of this title: *Provided*, That this section shall not conflict with that portion of section ten, of this title, under which a taxpayer has fixed its own fiscal year.

Information to be furnished at the source.—Sec. 26. Every corporation, joint-stock company or association, or insurance company subject to the tax herein imposed, when required by the Commissioner of Internal Revenue, shall render a correct return, duly verified under oath, of its payments of dividends, whether made in cash or its equivalent or in stock, including the names and addresses of stockholders and the number of shares owned by each, and the tax years and the applicable amounts in which such dividends were earned, in such form and manner as may be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury.

Sec. 27. That every person, corporation, partnership, or association, doing business as a broker on any exchange or board of trade or other similar place of business shall, when required by the Commissioner of Internal Revenue, render a correct return duly verified under oath, under such rules and regulations as the Commissioner of In-

ternal Revenue, with the approval of the Secretary of the Treasury, may prescribe, showing the names of customers for whom such person, corporation, partnership, or association has transacted any business, with such details as to the profits, losses, or other information which the commissioner may require, as to each of such customers, as will enable the Commissioner of Internal Revenue to determine whether all income tax due on profits or gains of such customers has been paid.

Sec. 28. That all persons, corporations, partnerships, associations, and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, receivers, conservators, and employers, making payment to another person, corporation, partnership, association, or insurance company, of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in sections twenty-six and twenty-seven), of $800 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, are hereby authorized to render a true and accurate return to the Commissioner of Internal Revenue, under such rules and regulations and in such form and manner as may be prescribed by him, with the approval of the Secretary of the Treasury, setting forth the amount of such gains, profits, and incomes, and the name and address of the recipient of such payment: *Provided*, That such returns shall be required, regardless of amounts, in the case of payments of interest upon bonds and mortgages or deeds of trust or other similar obligations of corporations, joint-stock companies, associations, and insurance companies, and in the case of collections of items (not

payable in the United States) of interest upon the bonds of foreign countries and interest from the bonds and dividends from the stock of foreign corporations by persons, corporations, partnerships, or associations, undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the person, corporation, partnership, association, or insurance company paying the income.

The provisions of this section shall apply to the calendar year nineteen hundred and seventeen and each calendar year thereafter, but shall not apply to the payment of interest on obligations of the United States.

Deduction of war excess profits tax.—Sec. 29. That in assessing income tax the net income embraced in the return shall also be credited with the amount of any excess profits tax imposed by Act of Congress and assessed for the same calendar or fiscal year upon the taxpayer, and, in the case of a member of a partnership, with his proportionate share of such excess profits tax imposed upon the partnership.

Exemption of income of foreign governments.—Sec. 30. That nothing in section II of the Act approved October third, nineteen hundred and thirteen, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," or in this title, shall be construed as taxing the income of foreign governments received from investments in the United States in stocks, bonds, or other domestic securities, owned by such foreign governments, or from interest on deposits in banks in the United States of moneys belonging to foreign governments.

Meaning of "dividends" and taxation of dividends.— Sec. 51. (*a*) That the term "dividends" as used in this title

shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of the earnings or profits so distributed.

(b) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made.

This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen.

Premiums on "business" life insurance not deductible.—Sec. 32. That premiums paid on life insurance policies covering the lives of officers, employees, or those financially interested in any trade or business conducted by an individual, partnership, corporation, joint-stock company or association, or insurance company, shall not

be deducted in computing the net income of such individual, corporation, joint-stock company or association, or insurance company, or in computing the profits of such partnership for the purposes of subdivision (*e*) of section eight.

Refund of tax withheld at the source in 1907.—Sec. 1212 [of Title XII.—"Income Tax Amendments" of Act of October 3, 1917]. That any amount heretofore withheld by any withholding agent as required by Title I of such Act of September eighth, nineteen hundred and sixteen, on account of the tax imposed upon the income of any individual, a citizen or resident of the United States, for the calendar year nineteen hundred and seventeen, except in the cases covered by subdivision (*c*) of section nine of such Act, as amended by this Act, shall be released and paid over to such individual, and the entire tax upon the income of such individual for such year shall be assessed and collected in the manner prescribed by such Act as amended by this Act.

Act of September 8, 1916, in effect September 9, 1916.

Effective date of Act as amended, October 4, 1917.

CHAPTER XIII — (*Continued*)

THE WAR INCOME TAX AFFECTING INDIVIDUALS AND COPORATIONS

TITLE I OF THE ACT OF OCTOBER 3, 1917 (PUBLIC—No. 50—65th Congress)

TITLE I—WAR INCOME TAX

Individual normal war tax rate.—Sec. 1. That in addition to the normal tax imposed by subdivision (*a*) of section one of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, there shall be levied, assessed, collected, and paid a like normal tax of two per centum upon the income of every individual, a citizen or resident of the United States, received iu the calendar year nineteen hundred and seventeen and every calendar year thereafter.

Individual additional war tax rate.—Sec. 2. That in addition to the additional tax imposed by subdivision (*b*) of section one of such Act of September eighth, nineteen hundred and sixteen, there shall be levied, assessed, collected, and paid a like additional tax upon the income of every individual received in the calendar year nineteen hundred and seventeen and every calendar year thereafter, as follows:

One per centum per annum upon the amount by which the total net income exceeds $5,000 and does not exceed $7,500;

Two per centum per annum upon the amount by which the total net income exceeds $7,500 and does not exceed $10,000;

Three per centum per annum upon the amount by which the total net income exceeds $10,000 and does not exceed $12,500;

Four per centum per annum upon the amount by which the total net income exceeds $12,500 and does not exceed $15,000;

Five per centum per annum upon the amount by which the total net income exceeds $15,000 and does not exceed $20,000;

Seven per centum per annum upon the amount by which the total net income exceeds $20,000 and does not exceed $40,000;

Ten per centum per annum upon the amount by which the total net income exceeds $40,000 and does not exceed $60,000;

Fourteen per centum per annum upon the amount by which the total net income exceeds $60,000 and does not exceed $80,000;

Eighteen per centum per annum upon the amount by which the total net income exceeds $80,000 and does not exceed $100,000;

Twenty-two per centum per annum upon the amount by which the total net income exceeds $100,000 and does not exceed $150,000;

Twenty-five per centum per annum upon the amount by which the total net income exceeds $150,000 and does not exceed $200,000;

Thirty per centum per annum upon the amount by which the total net income exceeds $200,000 and does not exceed $250,000;

Thirty-four per centum per annum upon the amount by which the total net income exceeds $250,000 and does not exceed $300,000;

Thirty-seven per centum per annum upon the amount

by which the total net income exceeds $300,000 and does not exceed $500,000;

Forty per centum per annum upon the amount by which the total net income exceeds $500,000 and does not exceed $750,000;

Forty-five per centum per annum upon the amount by which the total net income exceeds $750,000 and does not exceed $1,000,000;

Fifty per centum per annum upon the amount by which the total net income exceeds $1,000,000.

Specific exemptions from normal war tax.—Sec. 3. That the taxes imposed by sections one and two of this Act shall be computed, levied, assessed, collected, and paid upon the same basis and in the same manner as the similar taxes imposed by section one of such Act of September eighth, nineteen hundred and sixteen, except that in the case of the tax imposed by section one of this Act

(*a*) the exemptions of $3,000 and $4,000 provided in section seven of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, shall be, respectively, $1,000 and $2,000, and

(*b*) the returns required under subdivisions (*b*) and (*c*) of section eight of such Act, as amended by this Act, shall be required in the case of net incomes of $1,000 or over, in the case of unmarried persons, and $2,000 or over in the case of married persons, instead of $3,000 or over, as therein provided, and

(*c*) the provisions of subdivision (*c*) of section nine of such Act, as amended by this Act, requiring the normal tax of individuals on income derived from interest to be deducted and withheld at the source of the income shall not apply to the new two per centum normal tax prescribed in section one of this Act until on and after January first, nineteen hundred and eighteen, and thereafter only one two per centum normal tax shall be

deducted and withheld at the source under the provisions of such subdivision (*c*), and any further normal tax for which the recipient of such income is liable under this Act or such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, shall be paid by such recipient.

Corporation war income tax.—Sec. 4. That in addition to the tax imposed by subdivision (*a*) of section ten of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, there shall be levied, assessed, collected, and paid a like tax of four per centum upon the income received in the calendar year nineteen hundred and seventeen and every calendar year thereafter, by every corporation, joint-stock company or association, or insurance company, subject to the tax imposed by that subdivision of that section, except that if it has fixed its own fiscal year, the tax imposed by this section for the fiscal year ending during the calendar year nineteen hundred and seventeen shall be levied, assessed, collected, and paid only on that proportion of its income for such fiscal year which the period between January first, nineteen hundred and seventeen, and the end of such fiscal year bears to the whole of such fiscal year.

The tax imposed by this section shall be computed, levied, assessed, collected, and paid upon the same incomes and in the same manner as the tax imposed by subdivision (*a*) of section ten of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, except that for the purpose of the tax imposed by this section the income embraced in a return of a corporation, joint-stock company or association, or insurance company, shall be credited with the amount received as dividends upon the stock or from the net earnings of any other corporation, joint-stock company or association, or insurance company, which is taxable upon its net income as provided in this title.

Porto Rico and the Philippine Islands not affected.—Sec. 5. That the provisions of this title shall not extend to Porto Rico or the Philippine Islands, and the Porto Rican or Philippine Legislature shall have power by due enactment to amend, alter, modify, or repeal the income tax laws in force in Porto Rico or the Philippine Islands, respectively.

In effect October 4, 1917.

TITLE X.—ADMINISTRATIVE PROVISIONS OF THE ACT OF OCTOBER 3, 1917

(Public—No. 50—65th Congress)

[Effective October 4, 1917]

Prepayment of taxes.—Sec. 1009 [of Title X.—Administrative Provisions of the Revenue Act of October 3, 1917]. That the Secretary of the Treasury, under rules and regulations prescribed by him, shall permit taxpayers liable to income and excess profits taxes to make payments in advance in installments or in whole of an amount not in excess of the estimated taxes which will be due from them, and upon determination of the taxes actually due any amount paid in excess shall be refunded as taxes erroneously collected:

Provided, That when payment is made in installments at least one-fourth of such estimated tax shall be paid before the expiration of thirty days after the close of the taxable year, at least an additional one-fourth within two months after the close of the taxable year, at least an additional one-fourth within four months after the close of the taxable year, and the remainder of the tax due on or before the time now fixed by law for such payment:

Provided further, That the Secretary of the Treasury, under rules and regulations prescribed by him, may allow credit against such taxes so paid in advance of

an amount not exceeding three per centum per annum calculated upon the amount so paid from the date of such payment to the date now fixed by law for such payment; but no such credit shall be allowed on payments in excess of taxes determined to be due, nor on payments made after the expiration of four and one-half months after the close of the taxable year.

All penalties provided by existing law for failure to pay tax when due are hereby made applicable to any failure to pay the tax at the time or times required in this section.

Payment of tax with Treasury certificates and uncertified checks.—Sec. 1010. That under rules and regulations prescribed by the Secretary of the Treasury, Collectors of Internal Revenue may receive, at par and accrued interest, certificates of indebtedness issued under section six of the Act entitled "An Act to authorize an issue of bonds to meet expenditures for the national security and defense, and, for the purpose of assisting in the prosecution of the war, to extend credit to foreign governments, and for other purposes," approved April twenty-fourth, nineteen hundred and seventeen, and any subsequent Act or Acts, and uncertified checks in payment of income and excess profits taxes, during such time and under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions the same as if such check had not been tendered.

CHAPTER XIV

CAPITAL STOCK TAX

History of capital stock tax.—The law of September 8, 1916, under Title IV., Section 407, imposes an excise[1] tax on every domestic corporation the fair value of whose total outstanding capital stock exceeds $99,000 and on every foreign corporation engaged in business in this country. This excise tax, or as it is frequently called, the capital stock tax, was substituted for the special tax on bankers imposed under the Emergency Revenue Law of October 22, 1914. The distinction between the two is that the old law was a tax on every person, firm, or corporation engaged in banking, while the new law taxes every corporation, whether engaged in banking or any other business.

This tax is an excise tax on the privilege of doing business, and is similar to the occupational taxes imposed on individuals except that, instead of being a flat tax, the amount of the tax is measured by the average value of the stock during the preceding year.

Being a privilege or occupational tax, it is payable in advance annually in July, which is the beginning of the Government's fiscal year.

This law went into effect January 1, 1917, and the first tax collected was for the privilege of doing business for the half year from January 1, 1917, to June 30, 1917. The second tax was collected in July, 1917, and was for the privilege of doing business for the en-

[1] "Excise" is defined to be an inland imposition, sometimes upon the consumption of the commodity and sometimes upon retail sale, sometimes upon the manufacturer and sometimes upon the vendor. (22 Cyc. 1598.)

suing taxable year ending June 30, 1918. The tax is therefore payable every July for the privilege of doing business for the taxable year ending the following June 30th.

Capital Stock Tax independent of other taxes.—The Capital Stock Tax has no connection with the Income Tax, the War Excess Profits Tax, or with State capital stock taxes. It is an entirely separate and distinct tax. Reports for this tax are required to be made out on a separate form and filed at a different time from that of the filing of returns for any other tax.

Deduction of Munitions Tax.—The amount of tax paid under Section 301 of Title III of the act of September 8, 1916 (Munitions Manufacturer's Tax) since the filing of the last previous report may be deducted in computing the Capital Stock Tax.[1]

What United States corporations are subject to tax.—Every corporation, joint stock company or association, or insurance company, organized in the United States for profit, and having a capital stock represented by shares the fair value of which is in excess of $99,000, which was engaged in business during the preceding fiscal year, is subject to this tax unless specially exempted by the Act.

While the tax does not accrue except in cases where the valuation of the capital stock exceeds $99,000, a return must be filed in the case of a corporation the market value of whose capital stock outstanding is $75,000 or more.

Foreign corporations subject to tax.—Every corporation, joint stock company or association, or insurance company organized for profit under the laws of any foreign country and engaged in business in the United

[1] Credit cannot be had on capital stock tax return for 1917 for munitions tax paid in 1917, but as to whether such credit can be had against subsequent capital stock tax returns, in cases where the munitions tax is in excess of the capital stock tax paid, is a question not yet passed on by the Department, but which will be if it should arise.

States is subject to the tax on the value of the capital actually invested in the transaction of business in the United States. If the corporation makes a return showing the total amount of capital invested in the transaction of business both abroad and in this country it may deduct from the value of the capital invested in the United States such proportion of $99,000 as the amount invested in the United States bears to the total amount invested in the United States and elsewhere. To illustrate, a foreign corporation has $100,000 actually invested in the United States. Its total capital invested (including that invested in the United States) is $1,000,000. It will be allowed as a deduction 10% (100,000 ÷ 1,000,000) of $99,000, or $9,900.

Corporations need not have been in business during the entire preceding year.—It is not necessary that the corporation, to be liable, must have been engaged in business during the entire year ended June 30th. It is sufficient that the corporation was engaged in business at some time during the year. The length of time it was engaged in business has no bearing upon the amount of the tax to be paid.

Inactive corporations need not pay tax.—Corporations which were engaged in business at some time during the preceding fiscal year but which were not engaged in business at the time a return was due (i. e., July 1st to 30th, inclusive), are not required to file a return, but should they subsequently resume business they must file a return in the month in which they resume business.

Returns required of United States corporations.—Regulation Number 38, of the Treasury Department, provides that: "Every corporation, joint stock company or association, or insurance company organized in the United States for profit and having a capital stock issued and outstanding of the market value of $75,000 or over and not exempt by the act, shall make a return on Form 707 irrespective of the par value of its capital

stock, unless such corporation, joint stock company or association, or insurance company was not engaged in business during the preceding taxable year."

The phrase "of the market value of $75,000" as used in this decision should be held as meaning "of the fair value of $75,000." The tax is based upon the "fair value" of the stock. While the Treasury Department recognizes that the market value is the fair value where the market value can be obtained, it also provides a method of determining the fair value in cases where there is no basis from which to obtain the market value.

Returns will therefore be required of all corporations the fair value of whose stock is $75,000 or more, regardless of whether or not a market value has been established.

Returns required of every foreign corporation.—"Every corporation, joint stock company or association or insurance company, organized for profit under the laws of any foreign country and engaged in business in the United States, shall make return on Form 708 irrespective of the amount of capital employed either at home or in this country in the transaction of its business." (T. D. Reg. 38.)

Returns required from holding companies.—The filing of returns by its subsidiary companies does not relieve a holding company from its liability to the tax or from filing its own return.

Corporations exempt.—Section 407 of this Act exempts from the Capital Stock Tax all corporations which are exempt from the Income Tax under the provisions of section 11, Title I. For a list of such exempt classes of corporations, joint stock companies or associations, and insurance companies, see Chapter VII.

Although labor, agricultural or horticultural associations are exempt under the section referred to, this exemption does not include corporations engaged in general farming, raising cattle, or agricultural business for profit.

Mutual companies exempt.—Inasmuch as the basis of the tax is the fair value of the stock of a corporation, mutual insurance companies and other associations not having capital represented by shares will also be exempt from the tax because of the absence of a basis for the computation of the tax.

Massachusetts, or Common Law Trusts, exempt.—Massachusetts trusts, the so-called Common Law trusts, were held to be exempt from the Corporation Tax of 1909, under the decision in the case of *Eliot vs. Freeman et al.* (220 U. S. 178). In T. D. 2418, the Treasury Department stated that the ruling would be held to cover the Capital Stock Tax.

The court stated as follows: "The two cases under consideration embrace trusts which do not derive any benefit from and are not organized under the statutory laws of Massachusetts. Joint stock companies of the statutory character are not known to the laws of that Commonwealth. These trusts do not have perpetual succession but end with lives in being and 20 years thereafter.

"Entertaining the view that it was the intention of Congress to embrace within the Corporation Tax statutes only such corporations and joint stock associations as are organized under some statute or derive from that source some quality or benefit not existing at the common law, we are of the opinion that the real estate trusts involved in these two cases are not within the terms of the Act."

Domestic Building and Loan Associations organized and operated for mutual purposes and without profit are exempt.—The words "no part of the net income of which inures to the benefit of any private stockholder or individual" does not apply to domestic building and loan associations operated for the mutual benefit of members. See *Herold, Collector, vs. Park View B. & L. Ass'n.* (210 Fed. 577).

Corporations in the hands of receivers exempt.—Corporations which were in the hands of receivers at the due time of filing returns would not be required to make a return unless the receivership terminated before the close of the taxable period.

If the operation of the corporation were then resumed under corporate management, a return on Form 707 must be filed during the month in which operation was resumed. The tax would be computed proportionately from the first day of the month in which it resumes business to the end of the fiscal year.

Corporations operating under their corporate management but which were in the hands of receivers during the preceding fiscal year (July 1, 1916, to June 30, 1917), would not be required to file return during July, 1917, for the period ending June 30, 1918.

Corporations not engaged in business during preceding taxable year are exempt.—The last part of Section 407, Title IV, reads: "This tax shall not be imposed upon any corporation, joint stock company or association, or insurance company not engaged in business during the preceding taxable year."

When is a corporation not engaged in business.—The tax is an excise tax imposed on corporations. It is not imposed on the franchise of the corporation irrespective of its use in business, nor upon the property of the corporation, but it is imposed on the doing of corporate business and for the privilege of doing business.

The simple fact of holding a franchise does not make a corporation liable to the tax. It is necessary that a corporation do certain acts so that it may be held as engaged in business. The question of what degree of activity is necessary in order that a corporation be so held has been somewhat complicated by the varying views of the several court decisions rendered.

The Corporation Tax Law of 1909 levied a tax upon the net income of corporations "engaged in business."

Quite naturally the question arose as to the meaning of the term "engaged in business." A number of cases were decided in the Supreme Court and in the District courts defining the term.

Treasury Decision 2418, of December 15, 1916, relating to this point, is as follows:

"The following decisions, made in cases arising under the corporation tax act of August 5, 1909, will be followed where they are final or have been acquiesced in by the Department in similar questions arising under the special excise tax imposed by section 407, Title IV, Act of September 8, 1916."

Next followed the decisions in a number of Supreme Court cases, and also a list of a number of cases decided in the lower courts, ending with the statement:

"Corporations which are not 'engaged in business' or 'transacting business' as construed under the language of the courts in the above decisions are not subject to the special excise tax imposed under section 407 of the act of September 8, 1916."

Among the cases cited was the case of *United States vs. Nippissing Mines Company* (206 Fed. 431), in which it was held that a corporation owning the stock of a number of subsidiary companies receiving dividends on the stocks and distributing said dividends to its own stockholders was not engaged in business. When the first returns were due, in January, 1917, a number of corporations claimed exemption under this decision, and in answer to these claims the Treasury Department, in T. D. 2429, of January 4, 1917, stated as follows:

"In reply you are advised that this office has never acquiesced in the decision of the court in the case of *United States vs. Nippissing Mines Company,* and the question of whether a corporation organized for the purpose of acquiring and holding all the capital stock of subsidiaries, and actually engaged in holding such stock, voting thereon, receiving dividends when paid by

the subsidiaries, keeping books, and paying out money to its own shareholders, is now doing business within the meaning of the Corporation Tax Act of August 5, 1909, is now pending in the Circuit Court of Appeals for the Southern District of New York.

"This office is of the opinion, therefore, that a 'holding company' organized in the United States for the purpose of acquiring and holding capital stock of subsidiary companies and actually engaged in holding such stock, voting thereon, and distributing money among its own shareholders, is engaged in business within the meaning of the Act of September 8, 1916, and is subject to the special tax imposed under section 407. A ruling to this effect will be published in the weekly edition of Treasury Decisions, and will be followed by the Department until the Supreme Court decides to the contrary."

On January 15, 1917, the Supreme Court issued its decision in the case of *Baumbach vs. Sargent Realty Company.*

(T. D. 2436. Dated January 19, 1917. In part only.)
(*Decision.*)
Corporation Excise Tax Law of 1909.

SUPREME COURT OF THE UNITED STATES.

Fred Von Baumbach, Collector of Internal Revenue, Petitioner, *vs.* Sargent Land Company. Same, *vs.* Sutton Land Company. Same, *vs.* Kearsarge Land Company.	Writs of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[January 15, 1917.]

Mr. Justice DAY delivered the opinion of the Court.

STATEMENT OF FACTS.

These three cases were argued and submitted together and involve practically the same facts. Suits were brought by the corporations named in the United States District Court for the District of Minnesota against the Collector of Internal Revenue, to recover certain taxes, paid under protest, assessed under the Corporation Tax Law of 1909 (36 Stat. 11, 112), for the years 1909, 1910 and 1911. The judgments in the District Court were for the respondents (207 Fed. 423) which judgments were affirmed in the Circuit Court of Appeals (219 Fed. 31).

In 1890, John S. Pillsbury, George A. Pillsbury and Charles A. Pillsbury, doing business together as John S. Pillsbury & Company, were the owners of large tracts of lands in northern Minnesota, which nad been acquired for the timber and from which the timber had been cut, being valuable after such severance of the timber for the mineral deposits contained therein. In the year named, the Pillsburys entered into an arrangement with John M. Longyear and Russell M. Bennett, authorizing the latter two to explore the lands for iron deposits. In 1892, Longyear and Bennett having discovered valuable deposits of iron ore, a half interest in something over ten thousand acres of the lands was conveyed to them, the lands thereafter being owned by the Pillsburys, John, George and Charles, each an undivided sixth, and John M. Longyear and Russell M. Bennett each an undivided fourth. In the year 1901, the Pillsburys having died, these corporations were formed under the laws of Minnesota. In 1906, the ownership of these leased lands was vested in the three corporations named as respondents in the proceedings. As originally organized, the nature of the business was stated to be "the buying, owning, exploring and developing, leasing, improving, selling and dealing in lands, tenements and hereditaments, and the doing of all things incidental to the things above specified." In December, 1909, the articles of incorporation were amended to read as follows: "The general purpose of the corporation is to unite in one ownership the undivided, fractional interest of its various stockholders in lands, tenements and hereditaments, and to own such property, and, for the convenience of its stockholders, to receive and distribute to them the proceeds of any disposition of such property, at such times, in such amounts, and in such manner as the Board of Directors may determine."

All of the mining leases, hereinafter mentioned, with the exception of a contract with the Van Buren Mining Company, were executed before the organization of the corporations. Each of these instruments provided that the owners of the property demised to the lessees, exclusively, all the lands covered by the descriptions for the purpose of exploring for, mining and removing the merchantable iron ore which might be found therein for and during the period named, usually fifty years. The lessees were given exclusive right to occupy and control, the demised premises and to erect all necessary buildings, structures and improvements thereon. Right was reserved to the lessors to enter for the purpose of measuring the amount

of ore mined and removed and making observations of the operations in the mines. The lessees agreed to pay, in most cases, twenty-five cents per ton for all ore mined and removed, and to make such payments monthly for ore mined and shipped during the preceding month. The lessees agreed to mine and ship a specified quantity of ore in each year, and, in default of this, to pay the lessors for the minimum amount specified, and take credit therefor and apply such sums upon ore mined and shipped thereafter in excess of such minimum. The lessees were to pay the taxes and to keep the property free from encumbrances and liens. Right was reserved to terminate the contract upon the failure of the lessees to comply with the terms thereof.

The form of the leases is shown in Exhibits 15 and 16, which were not in the printed record, owing to their length, but copies of which, pursuant to stipulation, have been sent to this court. An examination of Exhibit 16 shows that the lessees had the right to terminate and surrender the lease by giving the lessors, or those having their estate in the premises, sixty days' written notice, and executing sufficient conveyances releasing all interest and right of the lessees in the premises with any improvements thereon, and surrendering the same in good order and condition, etc., and that thereupon all liability of the lessees to taxes subsequently assessed on the demised premises or for rent thereof thereafter to accrue, or royalty on ores therefrom except on account of ores removed, should cease and determine; the lessees to be liable for all ores removed from the premises not theretofore paid for, and to pay for the premises rent or royalty for the year in which termination should be made, or the portion thereof which should have expired, at the rate of $12,500.00 per annum.

Since their organization the corporations have disposed of certain lands and have also disposed of the stumpage on some timber lands. Certain parcels were rented and leased, and a village was allowed to use part of the land for schoolhouse purposes, as well as another part for a public park.

To insure the proper carrying on of the mining operations, the companies employed another corporation, engaged in engineering and inspection of ore properties, to provide supervision and inspection of the work upon the respondents' properties, for which the inspecting company was paid from month to month, as statements were rendered.

The companies were assessed upon their gross income, being the entire receipts of the companies from royalties on the leases collected in the years 1909, 1910, and 1911, and some sums received from the sales of lots, lands and stumpage, from which expenses and taxes were deducted, but no deduction was made upon account of the depletion of the ore in the properties, or on account of such sales.

The brief for the respondents states that these cases present for consideration four questions, which are:

"1. Are the respondents corporations organized for profit?

"2. Were the respondents carrying on or doing business during the years 1909, 1910, 1911?

"3. Were moneys received by the respondents during those years in

payment for iron ore, under the contracts covering their mineral lands, gross income, or did they represent, in whole or in part, the conversion of the investment of the corporations from ore into money?

"4. If such moneys were gross income, are the respondents entitled to make any deduction therefrom on account of the depletion of their capital investment?"

1. The Companies Were Organized for Profit.

* * * * * *

2. They Were Carrying on or Doing Business within the Meaning of the Act of 1909.

As to the second question: Were the respondents carrying on business, within the meaning of the Corporation Tax Act? This question was dealt with by this court in the first of the Corporation Tax Cases, Flint v. Stone Tracy Company, 220 U. S. 107. As the tax was there held to be assessed upon the privilege of doing business in a corporate capacity, it became necessary to inquire what it was to do business, and this court adopted with approval the definition, judicially approved in other cases, which included within the comprehensive term "business" that which occupies the time, attention and labor of men for the purpose of a livelihood or profit."

In that case a number of realty and mining companies were dealt with, and the Park Realty Company, organized to deal in real estate, and engaged at the time in the management and leasing of a certain hotel, was held to be engaged in business. It was also held that the Clark Iron Company, organized under the laws of Minnesota, and owning and leasing ore lands for the purpose of carrying on mining operations, and receiving a royalty depending upon the quantity of ore mined, was engaged in business.

At the same time, and decided with the main corporation tax case, this court held, in the case of Zonne v. Minneapolis Syndicate, 220 U. S. 187, that a corporation which owned a piece of real estate which had been leased for 130 years, at an annual rental of $61,000, and which had amended its articles of incorporation so as to limit its purposes to holding the title to the property mentioned, and, for the convenience of its stockholders, to receiving and distributing from time to time the rentals that accrued under the lease and the proceeds of any disposition of the land, was not engaged in doing business within the meaning of the act, by reason of the fact that the corporation had practically gone out of business and had disqualified itself from any activity in respect thereto.

The act next came before this court in the case of McCoach, Collector, v. Minehill Railway Company, 228 U. S. 295, in which it was held, distinguishing the case of the Park Realty Company, supra, and applying the case of Zonne v. Minneapolis Syndicate supra, to the facts before the court, that a corporation which had leased all its property to another, and was doing only what was necessary to receive and distribute

the income therefrom among stockholders, was not doing business within the meaning of the act.

In United States v. Emery, 237 U. S. 28, this court held that a corporation which merely kept up its organization, distributing rent received from a single lessee, was not doing business within the meaning of the act.

It is evident, from what this court has said in dealing with the former cases, that the decision in each instance must depend upon the particular facts before the court. The fair test to be derived from a consideration of all of them is between a corporation which has reduced its activities to the owning and holding of property and the distribution of its avails and doing only the acts necessary to continue that status, and one which is still active and is maintaining its organization for the purpose of continued efforts in the pursuit of profit and gain and such activities as are essential to those purposes.

From the facts clearly established in these cases, we think these corporations were doing business, within the meaning of the act. They were organized for the purposes stated, and their activities included something more than the mere holding of property and the distribution of the receipts thereof. As was found by the District Court, the evidence shows that these three companies sold, during each of the years named, quantities of real estate, and the same were not small. They sold stumpage from some of the properties which had been burned over, leased certain properties in the village of Hibbing, and granted leases to squatters. One of the companies made explorations and incurred expenses in the matter of test pits. They employed another company to see that the mining operations were properly carried on, and that the lessees lived up to the engagements of their contracts. "All these things indicate," said the learned district judge, "the doing of and engaging in business. It [the corporation] was doing the business of handling a large property, selling lots, and seeing that the lessees lived up to their contracts. If that is not engaging in business, I do not know what is." We agree that it certainly was doing business, and, as the Corporation Tax Act requires no particular amount of business in order to bring a company within its terms, we think these activities brought the corporations in question within that line of decisions in this court which have held such corporations were doing business in a corporate capacity within the meaning of the law.

3. The Royalties Received from Lessees were Income.

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4. No Allowance Could be Claimed Under the Corporation Tax Act of 1909 for Depletion of Natural Resources.

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Judgments reversed.

In this decision the court states: "It is evident from what this court has said in dealing with the former cases, that the decision in each instance must depend upon the particular facts before the court. The fair test to be derived from all of them is between a corporation which has reduced its activities to the owning and holding of property and the distribution of its avails and doing only the acts necessary to continue that status, and one which is still active and is maintaining its organization for the purpose of continued efforts in the pursuit of profit and gain and such activities as are essential to those purposes. From the facts clearly established in these cases, we think these corporations were doing business within the meaning of the Act."

This decision, published as T. D. 2436, laid down the general rule but did not cover any of the cases relating specifically to holding companies. In March, 1917, the United States District Court, Southern District of New York, upheld the decision in *United States vs. Nippissing Mines Company* in deciding the case of *The Butterick Company vs. United States* (206 Fed. 431). The court said: "The Government contends that the direction of the management of the subsidiary companies by the holding company was a doing of business which subjected the holding company to an excise tax. This direction was accomplished only by the control of the subsidiary companies through stock ownership. Of course, proxies had to be issued to vote at the meetings of the operating companies, and the directors of the latter were chosen by the owners of the stock. No holding company can exist without a corporate activity involved in the exercise of such control through its stock ownership in the operating company, but such corporate activity is not, under the authority of the *United States vs. Nippissing Mines Company* (206 Fed. 431), the exercise of a franchise which is subject to an

excise tax. The endorsement by the Butterick Company of the notes of its subsidiary company was the only fact which is to be added to the facts before the court in the case of *United States vs. Nippissing Mines Company, supra,* which was decided by the Circuit Court of this circuit, but this is not sufficient to differentiate that case from the action by the Butterick Company here under consideration."

The decision in the above case is not a Supreme Court decision, and therefore does not affect the Department's ruling that holding companies are taxable.

In the cases of real estate companies and other companies that have leased their entire property for a period of years, the rule laid down in *Baumbach vs. Sargent Realty Company,* as stated above, forms the best basis for deciding whether or not such a company is taxable.

With reference to a real estate corporation that was holding real estate for enhancement in value, making no sales whatever during the fiscal year July 1, 1916, to June 30, 1917, the Treasury Department ruled:

"The fact that this corporation is holding its property until it can obtain a fair price for it would indicate that the company is engaged in business for profit. As the corporation is performing some of the functions for which it is incorporated, it will, of course, be required to file a return of capital stock on Form 707 and pay the special excise tax for the period July 1, 1917, to June 30, 1918, and file that report during July, 1917.

When is a foreign corporation engaged in business in the United States?—The question of just what activities are necessary in order that a foreign corporation may be held as doing business in the United States has been

passed on in decisions under the corporation tax law of August 5, 1909. These decisions are reviewed in the case of *Laurenlide Company, Limited, vs. Durey, Collector of Internal Revenue* (231 Fed. 223).

The court states "doing business within the state" or "doing or transacting business in the United States" do not include the doing of a single act or the making of single contract, but do include a "continued series of acts by an agent or agents continuously within the state or the United States, as the case may be."

From this decision it will be seen that any corporation maintaining an agency or having a resident agent in the United States will be held as doing business in the United States. The tax, though, is based upon capital invested in the United States, and there are any number of firms doing a large volume of business without having any capital in the United States.

Take the case of a foreign steamship company plying between England and the United States. The steamships, if registered in a foreign port, cannot properly be considered as "capital actually invested in the transaction of business in the United States." The value of the steamships, therefore, should not be included as capital invested in the transaction of business in the United States on Form 708, although a return of capital stock should be filed irrespective of the amount of capital employed either abroad or in this country, inasmuch as this company was engaged in business in the United States. A leasehold interest in a dock in this country, however, may properly be considered as an asset of a foreign corporation and part of its capital invested in the United States.

The basis of the tax, and methods of valuation.—The Capital Stock Tax is an excise tax, payable in advance, for the privilege of doing business for a fiscal year. The amount of the tax is computed upon the average

fair value of the capital stock of the company for the preceding fiscal year at the rate of fifty cents ($.50) for each full $1,000.00 of such fair value.

The fair value of the capital stock of a corporation can be only an estimate. The Treasury Department, therefore, furnishes three methods of estimating the fair value of the capital stock of United States corporations. These methods are to be used in different cases to which they may be applicable or appropriate: Case I, where the stock is listed on an exchange; Case II, where the stock is not listed on an exchange but where sales of the stock have been made during the preceding fiscal year; Case III, where the stock is not listed on any exchange and where no sales have been made or where sales have been made and the price is unknown.

Case I. Where the stock is listed on an exchange.—If the stock is listed on any exchange its fair value will be determined by adding the quoted highest bid price for the stock on the last day of each month during the preceding fiscal year (or if no bid price was quoted on the last day of each month then the latest day in the month on which a bid was quoted) and dividing by 12, the result being the average bid price per share for that year. A corporation, if it prefers, may average the fair value throughout the entire fiscal year by showing on a statement attached to the back of the return the highest price bid for the stock on each day throughout the year.

Where the stock is subject to great fluctuations and the highest bid prices on the last day of each month do not indicate the fair value of the stock, the corporation should calculate the average bid price as instructed above and attach to the return a statement showing why the figures under the case do not indicate a fair value of the stock. This statement will be

taken into consideration when the assessment of the tax is made.

Case II. Where the stock is not listed on an exchange but where sales have been made.—If the stock is not listed on any exchange, but sales thereof have actually been made, and the price paid for the stock is known to the officer making the return, or can be discovered by him, the average price at which sales were made during the preceding fiscal year shall be the determining factor in ascertaining the fair value per share.

The "average price at which sales were made" should be used, and not the average selling price per share. Thus if 10 shares were sold at $100 and 1,000 shares were sold at $70, the "average price" at which sales were made would be $85 $\left(\frac{100 + 70}{2} = 85\right)$, which is the correct figure to use. The "average selling price" in such a case would be $70.29 $\left(\frac{10 \times 100 + 1{,}000 \times 70}{1{,}010} = 70.29\right)$, but this price will not be accepted as an average fair value. Corporations protesting against this method of computing the value of stock may file a statement with the return setting forth the facts in detail and requesting the local collector to bring the matter to the attention of the Commissioner of Internal Revenue.

Where the number of sales is small and the circumstances attending the sales are such that they do not indicate the fair value, the same procedure should be followed as suggested in Case I. The average price at which sales are made should be calculated and a statement attached to the report showing why it does not represent the fair value.

Case III. If the stock is not listed on an exchange or if no sales have been made.—If Case I and Case II cannot be applied, i. e., if the stock is not listed on any exchange, and no actual sales have been made during the preceding fiscal year, or if the price at which sales have been made is not known to the officer making the return, the fair average value of the capital stock shall be estimated, and the surplus and undivided profits for the preceding fiscal year will be taken into consideration as required by the statute, as well as the nature of the business, its earning capacity and average dividends paid or profits earned during the preceding five years. (Reg. 38.)

The book value of a stock includes the total par value of the stock, the surplus, and the undivided profits. Thus, if a corporation has 10,000 shares, par $100 per share, a surplus of $500,000, and undivided profit of $50,000, the book value of its stock would be $1,550,000, unless for any reason the book value is fictitious because in some way the assets have been overestimated in the books of the corporation.

The real value of a stock is determined by its earning capacity. A reasonable return per share will make a stock worth par. As the return increases the real value of the stock increases proportionately. If a return of 10% will make a stock worth par, a return of 20% will make its real worth twice par. If the par is $100, the real value per share is then $200. If the return is 5%, then the real value of the stock is $50. Just what rate of return is required to make a stock worth par depends upon the nature and hazards of the business of the corporation.

The Treasury Department has issued a statement of the rate of return on different classes of corporations which in its opinion is required to make their stock worth par.

Class of Corporation	Per Cent.
Banking:	
States west of Mississippi River.....	8
States east of Mississippi River.....	6
Mining..............................	10
Mercantile..........................	10
Industrial..........................	10
Oil-producing companies................	15
Oil-refining companies................	10
Public utilities......................	8

The stock of a manufacturing corporation earning 20% would be worth $200 a share. Multiplied by the number of shares outstanding, this would give the total fair value of the capital stock.

The earning capacity should be taken from the average profits per share for the last five years. The net income each year need not be taken from the income tax returns of that year. There are cases where the corporation has income which is not taxable under the income tax law or where the corporation has actually incurred expenses which are not deductible in the calculation of the income tax. For instance, that income which is derived from investments in bonds or securities of a State, municipality, or of the United States, that is not taxable under the income tax laws, should be included in the total net income entered on the return under Case III, inasmuch as this income was a great influence at times, so far as the valuation of a particular stock is concerned.

In the same way, interest actually paid during the year is not at all times allowed as an expense of operation of a corporation, due to the limitations as to the maximum that may be charged as an expense. (See Chapter IX.) Nevertheless, the total interest paid during the year should be included as an expense when determining net income for capital stock valuation. In such cases the corporation should use the figures actu-

ally shown on its books and which reflect its true earning capacity.

The net income each year should be divided by the number of shares outstanding[1] each year, the result being the earnings per share. If the par value of the shares is $100, the dollars earned per share is equivalent to the per cent earned per share. If the shares are more or less than $100 par, the per cent earned must then be calculated by dividing the earnings per share by the par value of the share.

To determine the average per cent earned, add the per cents earned per share in each of the five years and divide by 5. The rate thus determined should be capitalized at the fair rate of return so as to give the fair value per share, as indicated below.

Average Per Cent. Earned	Fair Value per Share (par $100.00)				
	At 6%	At 8%	At 10%	At 15%	At 20%
6	100	75	60	40	30
7	116	87	70	46	35
8	133	100	80	53	40
9	150	113	90	60	45
10	167	125	100	67	50
11	184	137	110	74	55
12	200	150	120	81	60
13	216	163	130	87	65
14	233	175	140	94	70
15	250	188	150	100	75
16	267	200	160	107	80
17	284	213	170	113	85
18	300	225	180	120	90
19	316	237	190	126	95
20	333	250	200	133	100
21	350	263	210	139	105
22	367	275	220	146	110
23	384	288	230	153	115
24	400	300	240	160	120

[1] Capital stock which has been issued by a corporation is regarded as being outstanding, even though it is afterwards acquired by the company for value, and carried on the books as treasury stock.

Fair value of total capital stock.—The fair value of the total capital stock is found by multiplying the fair value per share by the number of shares outstanding at the date of making the return unless the number of shares outstanding has changed during the fiscal year.

Increases or decreases in capital stock during fiscal year.—Where the capital stock has been increased or decreased the case will be governed by the ruling laid down in T. D. 2503, which reads as follows:

"If a corporation has increased or decreased its capital stock during the fiscal year, a statement should be attached to the back of the return setting forth the number of shares of stock outstanding each month, with the average fair value of the stock for that month, computed under one of the three cases."

The method of applying these instructions under various circumstances is as follows:

Proposition I.—Books of the corporation on Dec. 31, 1916 show:

Capital Stock, 1,000 shares, par $100. Total.	$100,000
Surplus	100,000
Total Book Value.....................	$200,000

On January 1, 1917, a stock dividend of 100% is declared.

The average earnings are $20 per share, or $20,000 per year.

Methods of determining fair value under the three cases mentioned above are as follows:

Case I

Year	Month	No. of Shares Outstanding	Highest Average Bid Price for Month	Fair Value
1916	July	1,000	$210	$210,000
	August	1,000	205	205,000
	September	1,000	200	200,000
	October	1,000	195	195,000
	November	1,000	190	190,000
	December	1,000	200	200,000
1917	January	2,000	105	210,000
	February	2,000	100	200,000
	March	2,000	90	180,000
	April	2,000	110	220,000
	May	2,000	95	190,000
	June	2,000	100	200,000
				$2,400,000

$2,400,000 ÷ 12 = $200,000, average fair value.

Case II

The same procedure is followed as in Case I, except that "Highest Sales Price During Month" is taken instead of "Highest Average Bid Price for Month."

Case III

The average earnings of $20 per share would give an estimated fair value per share (if the corporation is an industrial or mining company) of $200 per share. The question that arises is, "By what number of shares should this fair value per share be multiplied in order to arrive at the average fair value of the capital stock?" The face of the return (Form 707) calls for the number of shares outstanding at the time of filing the return, in this case 2,000 shares; the instructions on the reverse of the form are that the average number of shares outstanding should be used, in this case 1,500 shares.

Neither of the methods would give a true value. The increased number of shares merely represent a trans-

fer from the surplus to the par value of the capital stock outstanding. The amount of capital invested is the same and there should be no increase in the total fair value of the stock.

The method suggested by the Department when this specific case was put before them was to calculate the average earnings of the shares outstanding June 30, 1917, which would give an average earning per share of $10, and a fair value per share of $100, and then to multiply by the number of shares outstanding on June 30, 1917, or 2,000 shares. This would give a total fair value of $200,000. This method suggested by the Government has the merit of basing the entire problem on the number of shares that are actually outstanding at the time of making the return.

Proposition II.—On December 31, 1916, a corporation has outstanding 1,000 shares, par $100, total $100,000. On January 1, 1917, another 1,000 shares are issued for cash at par. The average rate of earnings is $10 per share, or $10,000 per year.

Case I

Year	Month	No. of Shares Outstanding	Highest Quoted Bid Price	Fair Value
1916	July	1,000	$99	$99,000
	August	1,000	101	101,000
	September	1,000	103	103,000
	October	1,000	102	102,000
	November	1,000	98	98,000
	December	1,000	101	101,000
1917	January	2,000	97	194,000
	February	2,000	100	200,000
	March	2,000	99	198,000
	April	2,000	101	202,000
	May	2,000	100	200,000
	June	2,000	99	198,000
				$1,796,000

$1,796,000 ÷ 12 = $149,666, average fair value.

Case II

Year	Month	No. of Shares Outstanding	Highest Sale Price Each Month	Fair Value
1916	July	1,000	$101	$101,000
	August	1,000	101	101,000
	September	1,000	101	101,000
	October	1,000	99	99,000
	November	1,000	100	100,000
	December	1,000	100	100,000
1917	January	2,000	102	204,000
	February	2,000	102	204,000
	March	2,000	102	204,000
	April	2,000	98	196,000
	May	2,000	98	196,000
	June	2,000	98	196,000
				$1,802,000

$1,802,000 ÷ 12 = $150,166, average fair value.

If there was no sale during the month, the last month's price should be used.

Case III

The average rate of earnings of $10 would give a fair value per share of $100. This should be multiplied by the average number of shares outstanding during the year, or 1,500 shares, giving an average fair value of $150,000, due to the fact that the additional number of shares issued by the corporation were sold for cash and the capital stock of the corporation was increased to that extent.

Proposition III.—Corporation books on December 31, 1916, show:

Capital Stock (1,000 shares at $100)	$100,000
Surplus	100,000
	$200,000

On January 1, 1917, 1,000 additional shares were issued and paid for at par. The earnings average $20 per share, or $20,000 per year.

Case I

Year	Month	No. of Shares Outstanding	Highest Quoted Bid Price	Fair Value
1916	July	1,000	$200	$200,000
	August	1,000	205	205,000
	September	1,000	210	210,000
	October	1,000	200	200,000
	November	1,000	195	195,000
	December	1,000	190	190,000
1917	January	2,000	150	300,000
	February	2,000	155	310,000
	March	2,000	145	290,000
	April	2,000	150	300,000
	May	2,000	160	320,000
	June	2,000	140	280,000
				$3,000,000

$3,000,000 ÷ 12 = $250,000, average fair value.

Case II

Year	Month	No. of Shares Outstanding	Highest Quoted Bid Price	Fair Value
1916	July	1,000	$200	$200,000
	August	1,000	200	200,000
	September	1,000	195	195,000
	October	1,000	195	195,000
	November	1,000	205	205,000
	December	1,000	205	205,000
1917	January	2,000	155	310,000
	February	2,000	155	310,000
	March	2,000	155	310,000
	April	2,000	145	290,000
	May	2,000	145	290,000
	June	2,000	145	290,000
				$3,000,000

$3,000,000 ÷ 12 = $250,000, average fair value.

If no sale has been made during the month, the figures of the previous month should be used.

Case III

The average earnings are $20 a share, which would give a fair value of $200 per share. If this were multiplied by the average number of shares outstanding, 1,500 shares, it would give a fair value of $300,000. This is not the average fair value of the total capital stock, which was figured under Cases I and II to be $250,000. The doubling of the number of shares did not mean the doubling of the amount of capital. The capital December 31, 1916, was $200,000 (capital stock, $100,000; surplus, $100,000). On January 1, 1917, an additional $100,000 was added, bringing the capital up to $300,000. This would make the average capital $250,000. In a case similar to this a statement should be attached to the back of the return setting forth the number of shares of stock outstanding each month, with the average fair value of the stock for that month, as worked out in Cases I and II.

Rate of earnings if calculated on the basis of capital.—If the earnings are calculated on the basis of the capital (i. e., par value of issued stock plus the surplus or undivided profits), instead of the number of shares, we can arrive at a fair value of the invested capital. If after determining this fair value of the invested capital the amount of capital is increased or decreased, the value of the invested capital is increased or decreased proportionately. Increases or decreases in capital stock are ignored except as the result of an increase or decrease in the amount of invested capital. In all cases this method would give the figure required by the law, namely, "the average fair value of the capital stock for the preceding fiscal year."

Turning back to the cases given in the foregoing paragraphs, the method would work out as follows:

In Proposition I the capital of $200,000 has an earning power of $20,000 per year. The corporation being an industrial company, the fair value of the capital is $200,000.[1]

The issuing of $100,000 par value of capital stock to distribute the 100% stock dividend neither increased nor decreased the amount of capital invested. The fair value of the capital remains at $200,000.

In Proposition II the capital was $100,000 and the earnings were $10,000 per year. This gives the fair value of the capital as $100,000. On January 1, 1917, 1,000 shares are issued for cash at par. This transaction adds $100,000 to the capital, an increase of 100%. The fair value of the capital is increased proportionately, becoming $200,000. The tax, however, is based on the average fair value during the year. The fair value for the six months from July 1, 1916, to Dec. 31, 1916, was $100,000; from Jan. 1, 1917, to June 30, 1917, it was $200,000. The average fair value is therefore $150,000.

In Proposition III the capital and the earning power are the same as in Proposition I, the fair value of the capital being $200,000. On January 1, 1917, 1,000 shares are sold at par. This transaction adds $100,000 to the capital, an increase of 50%. The fair value of the capital is increased proportionately, becoming $300,000. The average fair value of the capital is therefore $250,000 ($200,000 for the first six months and $300,000 for the second six months).

Cases where earning power will not be considered.—Corporations that have no regular earnings, such as companies organized for the purpose of developing and selling timber land, mining property, and other real prop-

[1] To the average business man it may seem a paradox to say there is such a thing as a fair value of capital. To him a dollar is worth a dollar. But the fact remains that from the investment point of view a dollar may be worth more than a dollar. The dollar that earns 20 cents a year is worth twice as much as the dollar that earns only 10 cents.

erty (including real estate), and corporations that have earned no profits in the past five years or have only been engaged in business one or two years, cannot well estimate the value of the stock from their earning capacity. They are permitted to estimate the fair value of the stock from the book value, and should attach a detailed balance sheet as of the close of the fiscal year to the back of the return.

Fictitious book values.—If the book value is fictitious, and is the result of overestimating the assets, this fact should be fully explained, either on the return or in a statement attached to the return.

Value of stock of subsidiaries.—Where a holding company owns all the stock of several subsidiaries, which stock is not listed on any exchange or has not been sold in the last fiscal year, it has been held that the fair value of the stock of such subsidiary companies may be estimated from the market value of the total capital stock of the holding company (the parent corporation).

The fair value of the total capital stock of the parent company is generally computed under Cases I or II, and therefore this amount may be divided among the subsidiaries in proportion to the total amount of net profits earned by the subsidiaries plus the amount of net profits earned by the parent company from actual operations and investments or holdings of stock in other companies.

Preferred and common stock under Case III.—Where there is more than one class of stock there is no provision under Case III for arriving at the fair value per share of each class separately, and therefore the earnings should be based on the total number of shares outstanding, giving an average fair value per share irrespective of the class of stock. This fair value will be multiplied by the total number of shares outstanding, in order to arrive at the total fair value.

Basis of tax for foreign corporations.—Foreign corporations are taxed on the basis of the average amount of capital actually invested in the transaction of business in the United States during the preceding fiscal year, with the provision that deposits or reserve funds maintained or held in the United States by insurance companies under the requirements of law or contract for the protection of or payment to or apportionment among policyholders shall be deducted.

Any surplus or undivided profits invested in United States bonds or other securities which have no connection whatever with the actual business of the corporation transacted in this country will not be considered as capital invested in the United States for the purpose of the tax.

Bank balances carried in the United States should be considered as capital in the United States if they are treated as such upon the books of the company.

The corporation may state on its return the amount of capital invested outside of the United States and deduct such proportion of $99,000 as the capital invested in the United States bears to the total capital both here and abroad.

Foreign insurance companies may state the amount of "surplus to policyholders" as shown by the conventional form of report to State insurance departments, for the fiscal year ended December 31st. In this case the only deduction allowed is the amount of deposits actually required by States in which the company is transacting business.

Rate and computation of tax for United States corporations.—The tax is at the rate of 50 cents on each full one thousand dollars of fair value of the capital stock in excess of ninety-nine thousand dollars.

When an inactive corporation resumes business the tax will be computed proportionately from the first day of the month in which it resumes business to the end of

the fiscal year. A corporation resuming business in August would be taxed at the rate of 45.83 cents instead of 50 cents per thousand dollars.

Domestic insurance corporations are not permitted to deduct reserves and deposits maintained or held in the United States for the protection of, or payment to, or apportionment among policyholders, as such reserves and deposits are reflected in the fair value of the stock as computed under Cases I, II and III.

The amount actually paid for munitions tax during the preceding fiscal year should be deducted from the amount of the tax.

No deductions are allowed United States corporations for capital invested in foreign countries.

Rate and computation of the tax for foreign corporations.—The tax is at the rate of 50 cents on each full one thousand dollars of capital invested in the transaction of business in the United States. The amount of capital invested in the United States is subject to two deductions: (1) the allowable proportion of $99,000; (2) the amount of reserves and deposits maintained or held in the United States by insurance companies as required by law or contract.

The amount actually paid for munitions tax during the preceding fiscal year should be deducted from the amount of the tax.

Returns due annually in July.—All corporations required to file returns should file them annually in July, with the Collector of Internal Revenue for the district in which the principal place of business of the corporation is located.

Returns may be made by Collector.—If any corporation fails to make a return at the time prescribed by law, or makes a false or fraudulent return, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise. Any return or

list so made and subscribed by a collector or deputy collector shall be prima facie good and sufficient for all legal purposes.

Forms are supplied by the Government, but failure to receive forms does not relieve from penalty.—Forms will be sent to all taxable corporations known to the collectors, but failure to receive a blank form does not relieve a corporation from the penalties prescribed for failure to make returns within the time required.

Extension of time.—If the failure to file a return or list is due to sickness or absence of an officer required to sign the return, the collector may allow an extension of not more than thirty days from July 31 in which to file the return.

Form of return for domestic corporations.—Domestic corporations are required to make returns upon Form 707, and foreign corporations upon Form 708.

Form 707 requires the following information:

1. Kind of business.
2. Par value of common stock.
3. Par value of preferred stock.
4. Total value of capital stock.
5. Amount of surplus.
6. Amount of undivided profits.

The figures given in answer to questions 5 and 6 should be as of the date of the return, but if these figures cannot be obtained, those of the end of the last calendar or fiscal year of the corporation may be used.

7. Average fair value per share, to be computed as indicated in any of the three cases.

Under Case III the "average dividends per share paid during preceding five years" is required. This is only for the information of the office of the collector of internal revenue in a case where a corporation shows an earning capacity but does not state any surplus or undivided profits.

8. Number of shares of common stock outstanding June 30, multiplied by average value per share as arrived at under No. 7, giving total fair value of common stock.
9. Number of shares of preferred stock outstanding June 30, multiplied by average value per share as arrived at under No. 7, giving total fair value of preferred stock.
10. Fair value of total capital stock for preceding fiscal year ended June 30, the sum of 8 and 9.
11. Deduction allowed by law—$99,000.
12. Amount of fair value of stock over $99,000.
13. Tax at rate of 50 cents per year for each full $1,000.
14. Deduction of amount of munitions tax paid.
15. Amount of tax due.

This return must be signed and sworn to by two officers of the corporation before an officer authorized to administer oaths, and the seal of the attesting officer, if he is required to have a seal, must be impressed on the return.

Form of return for foreign corporations.—Form 708, for foreign corporations, requires the following information:

1. Kind of business.
2. Capital invested in the United States. (This should be the average amount invested during the year.)
3. Capital invested in foreign countries. The law does not require this to be the average capital invested. The figure used may be either that of June 30th or of the end of the fiscal year of the corporation.
4. Total capital invested by the corporation both in the United States and elsewhere — the sum of 2 and 3.

5. Amount of capital invested in the United States (brought down from Item 2 above), and percentage of total capital invested in the United States.
6. Deductions allowed by law.
   (1) Reserves and deposits of insurance company.
   (2) Proportion of $99,000.
7. Amount of capital on which tax should be computed.
8. Tax at rate of 50 cents per year.
9. Deduction of munitions tax paid.
10. Amount of tax due.

This return must be signed and verified by the agent or attorney, or other principal officer in charge of the United States branch of the foreign corporation, and must be sworn to before an officer authorized to administer oaths, and the seal of the attesting officer, if he is required to have a seal, must be impressed on the return.

Tax payable when notice of assessment has been given.—The tax may be paid at the time of filing or at any time subsequent, but no penalty will be attached until assessment is made and ten days' notice given and demand made on the official form (Form 17) for the tax.

Payment may be made in cash or by certified check.

Receipts need not be displayed.—The corporation will receive a receipt as evidence of the payment of the tax, but will not be required to display same as if it were a special stamp tax.

Penalty for failure to file return.—In case of failure to make and file a return within the time prescribed by law, there shall be added to the tax 50% of its amount, and the corporation shall be liable to a fine of not more than $500.

Subsequent voluntary returns.—Should a return be filed voluntarily after the time required by the law, without

notice from the collector, no 50% penalty will attach if it is shown that the failure to file the return was due to a reasonable cause and not to wilful neglect.

Penalty for false or fraudulent return.—In case a false or fraudulent return or list is wilfully made, the Commissioner of Internal Revenue shall add to the tax one hundred per centum of its amount.

Penalty for failure to pay tax when due.—Upon failure to pay the tax assessed within ten days after notice and demand, a penalty of 5 per cent of the tax unpaid and interest at the rate of 1 per cent per month until paid shall be added to the amount of such tax.

Specific penalty for failure to pay tax.—Section 408, Title IV, of the Act of September 8, 1916, provides that every person who carries on any business or occupation for which special taxes are imposed by this title, without having paid the special tax therein provided, shall, besides being liable to the payment of such special tax, be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not more than $500 or be imprisoned not more than six months, or both, in the discretion of the court.

CHAPTER XV

CAPITAL STOCK TAX LAW

BEING TITLE IV OF "AN ACT TO INCREASE THE REVENUE AND FOR OTHER PURPOSES," APPROVED SEPTEMBER 8, 1916 (PUBLIC —NO. 271—64th CONGRESS) IN EFFECT SEPTEMBER 9, 1916.

Excise tax on domestic and foreign corporations.—Sec. 407. That on and after January first, nineteen hundred and seventeen, special taxes shall be, and hereby are, imposed annually, as follows, that is to say: Every corporation, joint-stock company or association, now or hereafter organized in the United States for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States, or any State or Territory of the United States, shall pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint-stock company or association, or insurance company, equivalent to fifty cents for each $1,000 of the fair value of its capital stock and in estimating the value of capital stock the surplus and undivided profits shall be included: Provided, That in the case of insurance companies such deposits and reserve funds as they are required by law or contract to maintain or hold for the protection of or payment to or apportionment among policyholders shall not be included. The amount of such annual tax shall in all cases be computed on the basis of the fair aver-

age value of the capital stock for the preceding year: provided, That for the purpose of this tax an exemption of $99,000 shall be allowed from the capital stock as defined in this paragraph of each corporation, joint-stock company or association or insurance company. And provided further, That a corporation, joint-stock company or association, or insurance company, actually paying the tax imposed by section three hundred and one of Title III [Munition Manufacturer's Tax] of this Act shall be entitled to a credit as against the tax imposed by this paragraph equal to the amount of the tax so actually paid: And provided further, That this tax shall not be imposed upon any corporation, joint-stock company or association, or insurance company not engaged in business during the preceding taxable year, or which is exempt under the provisions of section eleven, Title I, of this Act.

Every corporation, joint-stock company or association, or insurance company, now or hereafter organized for profit under the laws of any foreign country and engaged in business in the United States, shall pay annually a special excise tax with respect to the carrying on or doing business in the United States by such corporation, joint-stock company or association, or insurance company, equivalent to 50 cents for each $1,000 of the capital actually invested in the transaction of its business in the United States: Provided, That in the case of insurance companies such deposits or reserve funds as they are required by law or contract to maintain or hold in the United States for the protection of or payment to or apportionment among policyholders shall not be included. The amount of such annual tax shall in all cases be computed on the basis of the average amount of capital so invested during the preceding year: Provided, That for the purpose of this tax an exemption from the amount of capital so invested shall be allowed equal to such proportion of $99,000 as the

amount so invested bears to the total amount invested in the transaction of business in the United States or elsewhere: Provided further, That this exemption shall be allowed only if such corporation, joint-stock company, or association, or insurance company makes return to the Commissioner of Internal Revenue, under regulations prescribed by him, with the approval of the Secretary of the Treasury, of the amount of capital invested in the transaction of business outside the United States: And provided further, That a corporation, joint-stock company or association, or insurance company, actually paying the tax imposed by section 301 of Title III [Munition Manufacturer's Tax] of this act, shall be entitled to a credit as against the tax imposed by this paragraph equal to the amount of the tax so actually paid: And provided further, That this tax shall not be imposed upon any corporation, joint-stock company or association, or insurance company not engaged in business during the preceding taxable year, or which is exempt under the provisions of section eleven, Title I, of this act.

Penalties for evasion of tax.—Every person who carries on any business or occupation for which special taxes are imposed by this title, without having paid the special tax therein provided, shall, besides being liable to the payment of such special tax, be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not more than $500, or be imprisoned not more than six months, or both, in the discretion of the court.

Administrative provisions. — Sec. 409. That all administrative or special provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this title, and every person, firm, company, corporation, or association liable to any tax imposed by this title, shall keep such records and render, under oath.

such statements and returns, and shall comply with such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may from time to time prescribe.

Approved by the President, September 8, 1916.

CHAPTER XVI

FEDERAL INHERITANCE OR ESTATE TAX

INTRODUCTION

Origin of inheritance taxes.—A little less than a decade ago inheritance taxes were practically unknown in the United States. They are, however, of ancient origin. Historians tell us that over two thousand years ago they were imposed by the Romans, where, perhaps, the idea had been introduced from Egypt, while in the Middle Ages it seems they existed as an incident of feudal tenures. Today practically every civilized nation has adopted some system of inheritance taxation, while in the United States all but five States [1] have enacted such laws.

Inheritance taxes in the United States.—As a means of contributing to the income of the Federal Government, inheritance taxes are not new. The first tax of this nature was imposed by the Stamp Act of July 6, 1797, which was repealed five years later. The War Revenue Act of July 1, 1862, included an inheritance tax, which remained in force until July 14, 1870. Although the income tax provisions of the Revenue Act of August 27, 1894, embraced inheritances, the scheme failed, when the law was declared unconstitutional. The next inheritance tax law passed by Congress was the War Revenue Act of June 13, 1898, which, so far as the inheritance feature is concerned, was repealed April 12,

[1] Ala., Fla., Miss., N. Mex., and S. Car.

1902. Finally, on September 8, 1916, the national legislature passed an "Act to Increase the Revenue and for Other Purposes," imposing an "estate" tax on the property of resident and non-resident decedents alike, which has twice been amended for the purpose of increasing the rates.

Earlier laws were emergency measures.—Prior to September 8, 1916, inheritance taxes were adopted by the Federal Government as an emergency measure, as was done subsequent to the Revolutionary War and during the Civil and the Spanish-American Wars, while it seems to have been taken for granted that, in normal times at least, this method of raising money should be left to the States. The new law, however, was passed at a time when we were at peace and enjoying unusual prosperity. Does it herald the era when all inheritance taxation will be reserved exclusively to the Federal Government, while the States merely will participate in the proceeds?

The Act of September 8, 1916.—Unlike most inheritance tax laws, the Act of September 8, 1916, imposes a tax on the entire net estate, instead of on each distributive share. The law also requires the executor, under certain conditions, to file a notice with the Collector of Internal Revenue within thirty days after qualifying or coming into possession of property of the decedent, and to file a return and to pay the tax on or before one year after the death of the decedent. In some instances, donees, beneficiaries, heirs, trustees, fiduciaries, transfer and paying agents and registrars must file the notice, make the return and pay the tax. A penalty of $500 is imposed where the notice or the return is not filed on time, and for making any false statement a fine of $5,000, with perhaps imprisonment.

As mentioned above, the original "estate" tax law passed September 8, 1916, has been amended twice for the purpose of increasing the rates. The rates pro-

vided in the original act apply to the net estate of every decedent dying on and after September 9, 1916, to and including March 2, 1917. The rates provided in the first amendment apply to the net estate of every decedent dying on and after March 3, 1917, to and including October 3, 1917. The rates provided in the second amendment apply to the net estate of every decedent dying on and after October 4, 1917 (except where the decedent died while serving in the military or naval forces of the United States, during the continuance of the war in which the United States is now engaged, or if decedent died from injuries, or disease, while in the service, within one year after the termination of the war).

The administration of the law is governed by regulations and decisions issued by the Treasury Department.

In the succeeding paragraphs there have been defined the duties of executors, administrators and others, as required by the law, regulations and treasury decisions issued to date of publication of this book.

DEFINITIONS OF TERMS

Several terms are used in the law and regulations, which, in addition to their common import, have been assigned special meanings. It is thought best, therefore, to define their exact meaning under the law.

Collector.—This term means the collector of internal revenue of the district in which the decedent maintained his legal residence at the time of his death. If the decedent resided outside of the United States, then the term "collector" means the collector of the district in which is located the decedent's property. If a non-resident decedent leaves property in more than one district, then the term means the collector at Baltimore, Maryland.

The Act does not distinguish between citizens and

aliens, but does distinguish between residents and non-residents of the United States at the time of their death. If a citizen of the United States[1] has maintained his principal domicile abroad prior to his death, his estate is taxable as that of a non-resident.

Executor.—This term includes an executor, or administrator, of the estate of a decedent. If there is no executor or administrator, the term nevertheless includes any person having or coming into possession of property of the decedent.

Exemption.—This term means the $50,000 specific exemption permitted to be deducted from the gross estate in determining the amount of the net estate of a resident decedent, whether citizen or alien of the United States. (See "Net Estate.") (Law—Sec. 203; Reg.—Art. 20.)

Gross Estate.—This term includes all property, both real and personal, tangible or intangible, wherever situated at the time of a resident decedent's death; and all property situated in the United States at the time of a non-resident decedent's death. It also includes any transfer, either in trust or otherwise, of property, except for a fair consideration in money or money's worth, effected by a taxable decedent at any time during his life but in contemplation of death, regardless of whether the transfer was fully effected or the instrument of transfer executed before or after the passage of the taxing act of September 8, 1916.

It has been held that the language of the Act is so specific that it was clearly the intent of Congress "to include not only such transfers, including gifts and sales not bona fide, made by instrument dated after

[1] The term United States means only the States, the Territories of Alaska and Hawaii and the District of Columbia. The tax is not imposed in Porto Rico, the Philippine or Virgin Islands, but the property in the United States of deceased residents of these islands is taxable as the property of non-residents.

September 8, 1916, or when the actual transfer took place after that date, but transfers of any kind made in contemplation of death at any time whatsoever prior to September 8, 1916. It is believed also that there is no question of the power of Congress to enact such revenue legislation. The test of the tax liability is not in such cases the date of the instrument making the transfer, or the date of the actual transfer, but the date of the death of the decedent."

The term includes the interest of the decedent in any property held jointly by the decedent and any other person, or deposited in banks or otherwise. It does not include the interest which a decedent had in property devised to him for life only, with the remainder vested in another. But a vested remainder in property, subject to a life tenancy, should be included in gross estate. This is for the reason that the estate tax is based upon the actual value of the interest of the decedent at the time of death. The value of the vested remainder is computed by reference to mortality tables.

In computing the value of the gross estate no provision is made for the deduction of the widow's dower or husband's curtesy.

Gross estate also includes accrued interest on securities, and accrued dividends on preferred stock, if fixed and certain, to the day of death, and all other dividends that were declared prior to the day of death. Income of the estate and appreciation of values after death are excluded.

All insurance, not payable directly to a beneficiary named in the policy, is included, also any accrued dividends.

All property over which decedent exercised his power of appointment is also included.

Stock in a domestic corporation and held by a nonresident decedent is a part of the gross estate, and is deemed property within the United States, even though

actually situated outside the United States at the time of decedent's death.

Gross estate does not include any bonds of domestic corporations owned by a non-resident physically located outside the United States at the time of his death. However, a tax is imposed upon the value of bonds, both foreign and domestic, owned by a non-resident decedent which bonds were physically situate in the United States, Hawaii or Alaska at the time of the owner's death, and the value of such bonds must be included as a portion of his gross estate.

Bonds, both foreign or domestic, owned by a resident decedent are taxable regardless of where such bonds are situated at the time of the owner's death.

The value of United States and other "tax exempt" bonds owned by the decedent is a part of the gross estate.

One-half of the value of so-called "community property"[1] should be included in the gross estate of the decedent husband or wife. If the survivor's interest be that merely of dower or curtesy, then the whole value of the "community property" is to be included in the gross estate of the decedent.

Household goods and other miscellaneous personalty of like nature used by husband and wife in the marriage relation are presumed to be the property of the husband and must be included in his gross estate. If the widow claims any part as her separate property she must furnish evidence showing that such articles were (1) owned by her prior to marriage; or (2) purchased out of her separate funds; or (3) acquired by gift or inheritance to her direct.

[1] In Texas, and in a few other States, all property earned or acquired by purchase or by gift (with one or two exceptions) by a husband or wife during the period of their marriage, is termed "community property." Such property is owned jointly by the husband and wife, and upon the death of either, the title thereto vests absolutely in the survivor. A similar condition exists in Pennsylvania, respecting real property, in cases where the conveyance is made to both the husband and wife.

The value of loans evidenced by promissory notes is to be included in the gross estate, even though by will the decedent provides that the notes shall be cancelled.

The gross value of mortgaged property must be shown in the gross estate, and the amount of the mortgage treated as a deduction. Thus, if a decedent's estate consists exclusively of real property valued at $75,000, against which there is a mortgage of $40,000, the gross estate must be reported at $75,000, even though the equity of the decedent is but $35,000.

Net Estate.—"Net estate" means that portion of the gross estate remaining after deductions for the following have been made:

(*a*) *Resident's Estate:*

(1) Funeral expenses; administration expenses, including the executor's and attorney's fees and miscellaneous expenses, but excluding all State inheritance taxes; claims against the estate, including mortgages and debts of the decedent; losses arising from fires, storms, shipwreck, or other casualty, and from theft during administration and not compensated for by insurance or otherwise; support during settlement of the estate of those actually dependent upon the decedent; and such other charges, if any, as are allowed by the local laws under which the estate is being administered.

(2) A specific exemption of $50,000.

(*b*) *Non-Resident's Estate:*

Such a proportion of the items specified in section (a), subdivision 1, above, as the proportion of decedent's property located within the United States bears to the total amount of decedent's property wherever situated, provided the executor includes in the return required to be filed the value at the time of his death of that part of the gross estate of the non-resident not situated in the United States.

The specific exemption of $50,000, or any portion

thereof, allowed to a resident decedent's estate is not allowed a non-resident decedent's estate.

It should be noted that no claim for deduction will be allowed unless the amount claimed has been actually expended, and is within the statutory limitation, if any, of the local jurisdiction.

Amounts paid for the support of dependents will not be allowed as a deduction unless all and each of the following conditions exist:

1. There must be an actual expenditure of money —not merely its equivalent;
2. The persons for whose support the money is expended must be actually dependent upon the deceased—if they have independent means, the claim will not be allowed.
3. The amount actually expended must not exceed the limit set by the local laws under which the estate is being administered.

Losses sustained through sale of assets at less than the inventory value are not allowed as a deduction.

In the schedule of assets of a certain estate the stocks and bonds owned by the decedent at time of death were inventoried at $388,000, and during the administration of the estate all were sold to raise the necessary cash to pay pecuniary legacies and taxes. The amount realized from the sale was $361,000, so that there was a determined loss to the corpus of the estate of $27,000, arising from the necessity of administration. It was stated that the executor had used his best judgment in making sales, but due to the state of the security market it was impossible to realize on even the most gilt-edged securities without taking some loss from quotations on the market at the date of the decedent's death. Under these circumstances it was argued this loss to the estate should be included among the deductions from the gross estate allowed in com-

puting the tax; also, that inasmuch as the purpose of making these sales was to provide for the payment of pecuniary legacies and of the State and Federal taxes, the loss so sustained should be allowed either under "Administration expenses" or "Determined losses during administration." The Treasury Department held: "The value of securities as of the date of decedent's death should be returned as a portion of his gross estate. Any subsequent depreciation or appreciation is not considered for Federal Estate Tax purposes. Losses occurring during administration which are deductible are set out in Section 203 (1)[1] of the Act of September 8, 1916, and losses other than those specifically enumerated are not deductible."

Prior to September 10, 1917, the Treasury Department (T. D. 2395) held that amounts paid to States on account of inheritance, succession or legacy taxes were a lawful deduction, but T. D. 2524 revoked this ruling, so that State inheritance taxes are not now deductible. This ruling also applies to non-resident decedents' estates. The Federal estate tax is not determined, does not attach and cannot be assessed or paid until the net estate upon which it is based has been exactly established. The estate tax, therefore, cannot be deducted from the gross estate to determine the taxable net estate.

Non-resident decedent.—The term "non-resident decedent" includes aliens and citizens of the United States residing outside of the United States at the time of their death. For example, the estate of a citizen of the United States who had prior to his death maintained his principal residence in London, would be taxed as that of a non-resident. Residents of the Philippine Islands and Porto Rico are taxed as non-residents upon any property in the United States.

[1] Such losses are those arising from fires, storms, shipwrecks or other casualty, and theft, when not compensated for, by insurance or otherwise.

Notice.—(Also termed "Thirty-day Notice," Forms 704, 705 and 714.) "Notice" means the written notice required to be filed with the collector within thirty days after letters testamentary or of administration are granted, or within thirty days after coming into possession of property of the decedent, except where possession of the property was obtained prior to decedent's death, in which case the notice must be filed within thirty days after decedent's death. Executors and administrators are required to file Form 704; transfer agents and registrars, Form 714, and all others must file Form 705.

Person. — "Person" includes partnerships, corporations and associations.

Resident decedent.—This term includes citizens and aliens residing at the time of their death in the United States.

Return.—"Return" (Form 706) means the statement required to be executed by the executors and filed with the collector within one year after the decedent's death, setting forth in detail the amount of the gross estate, the deductions allowed, the amount of the net estate and the tax payable thereon. This return is required in the case of resident decedents where the gross estate exceeds $60,000, or where the net estate exceeds the specific exemption of $50,000. A return is required for every non-resident decedent's estate regardless of the size of the estate.

United States.—The term "United States" includes all the States, the territories of Alaska and Hawaii, and the District of Columbia. It does not include the Philippine Islands, the Virgin Islands or Porto Rico.

DUTIES OF EXECUTORS AND ADMINISTRATORS

Thirty-day Notice—Form 704.—Every executor or administrator, within thirty days after qualifying as such,

or after coming into possession of any property of the decedent, whichever event first occurs, shall give written notice thereof on Form 704 to the collector of internal revenue in whose district was decedent's domicile at the time of death; and in the case of a non-resident, with the collector of the district in which the property is located. If the non-resident's property is located in more than one district, the notice must be filed with the collector at Baltimore, Md.

However, if the decedent was a resident of the United States, and the gross estate does not exceed \$60,000 or the net estate does not exceed \$50,000, then such notice is not required to be filed.[1] (See back of Form 704.) But, where the gross estate exceeds \$60,000, even though the net estate may be less than \$50,000, such notice must be filed.[2] (Reg.—Art. 32.)

Ancillary executors or administrators of non-resident decedents' estates are required to file Form 704 within the time specified above, regardless of the size of the decedent's estate. The estate of a non-resident decedent is liable for the tax upon that portion of the estate physically situated within the United States, and, in addition, upon the value of the stock of domestic corporations owned by the decedent at the time of his death, whether or not such stock be physically located in the United States. Bonds of domestic corporations owned by non-resident decedents and physically located outside of the United States are not deemed "property within the United States."

The filing of the notice should not be delayed in order to secure exact information concerning the value of the gross or net estate. Approximate figures may be given.

[1] For example, if the gross estate amounts to \$58,000, and the net estate to \$48,000, the notice will not be required. But, even though the gross estate is only \$58,000, if the net estate is over \$50,000 (that is, in excess of the specific exemption), the notice must be filed.

[2] Thus, if the gross estate is \$65,000 and the net estate \$45,000, the notice must be filed.

Return—Form 706.—It is the duty of every executor or administrator to file, within one year after the decedent's death, a return on Form 706, where the gross estate of a *resident* decedent exceeds $60,000 or the net estate exceeds $50,000. If, at the expiration of the year, it is impossible for the executor to show upon the return complete and accurate data of the gross estate and deductions, he should file a tentative return, and inform the collector of the cause for delay. The collector will, in his discretion, extend the time for filing the final return.

A return is required of the estate of every non-resident owning property physically located within the United States, or owning stocks of domestic corporations regardless of their physical situs.

Payment of tax.—The tax is due and payable one year after the decedent's death, and should be paid by the executor or administrator. A discount at the rate of 5 per cent per annum is allowed for prior payment. If the tax is not paid within 90 days after it is due interest is added at the rate of 10 per cent or 6 per cent per annum, as the case may be, calculated from the day of decedent's death to the date of payment, and the tax becomes a lien on the gross estate for ten years. (See Payment of Tax; Penalties.)

It is important for the executor to keep in mind that Section 208 of the law expressly provides that, so far as it is practicable and unless otherwise directed by the will of the decedent, the tax must be paid out of the estate before its distribution. This brings up the question in a testate's estate whether the tax shall be shared proportionately by all the legatees, or borne entirely by the residuary legatee. Where the testator expressly directs that all inheritance taxes be paid out of the residuary estate, the will, of course, governs. But, where the will is silent, whether or not the tax is to be borne by the residuary legatee depends upon the laws of the

State where the estate is administered. If the laws of the State make no provision for the apportionment of the tax, the executor should petition the surrogate, or the judge of the probate court, for an order expressly directing the apportionment of the tax, rather than assume that it should be borne by the residuary estate. In the case of an estate of a decedent who died without making a will, this question will not be encountered; the residuary estate, after being charged with the amount of the tax, will be distributed among the heirs and next of kin according to law.

DUTIES OF BENEFICIARIES, HEIRS, DONEES, TRUSTEES AND FIDUCIARIES

Where the estate of a decedent is represented by a duly appointed executor or administrator, no obligation to file the thirty-day notice (Form 705), or the return (Form 706) or to pay the tax is imposed upon a beneficiary,[1] heir, donee, trustee or fiduciary. It is only in cases where a taxable estate has no duly appointed representative, or where property of the decedent passes directly to the beneficiary without coming under the control of the executor, that the beneficiary, or his guardian, trustee or fiduciary must file the notice and return and pay the tax. In this respect the Solicitor of Internal Revenue has given his opinion, as follows:

"The said law defines the term 'executor' as meaning 'the executor or administrator of the decedent, or, if there is no executor or administrator, any person who takes possession of any property of the decedent,'" and further states:

"Manifestly the purpose of the law is to secure such information and returns as will enable the Government

[1] Wherever the term "beneficiary" is used in this chapter, it includes heirs, donees, trustees, fiduciaries, and all other persons holding property of a decedent.

to properly execute the law and collect such taxes as may be thereby imposed.

"In view of this uniform interpretation as to the requirement of notice and returns in all matters of revenue taxation, as well as the specific language of the law, I am of the opinion that you are justified in the preparation of regulations requiring persons who come into the possession of the property of a decedent, or any part thereof, prior to the appointment of executors or administrators, to give due and proper notice to the Collector of that fact. When executors or administrators are appointed they, of course, supersede all other persons in the control of the property, whether such persons are in possession or not, and the duty of giving notice and making returns for the entire estate immediately devolves upon such executors or administrators."

It is the intention of the Treasury Department to give a broad construction to the expression "any person who takes possession of any property of the decedent" contained in Section 200, and to impose upon such persons the duties and obligations of executors, where none has been duly appointed.

The law contemplates also that the notice should be filed by all persons who shall have received, within two years prior to the death of the decedent, any material part of decedent's property either as a gift in contemplation of death, or by a transfer intended to take legal effect at or after decedent's death, or by a so-called sale which was not a bona fide sale for a fair consideration in money or money's worth. With the notice to the collector, the donee or transferee may file such evidence as may be desired to establish whether the gift or transfer was in contemplation of, or intended to take effect at, the donor's or transferror's death, or whether the sale was bona fide.

Thirty-day Notice—Form 705.—Where the estate is not represented by a duly appointed executor or adminis-

trator, Form 705 must be filed within 30 days after the death of the decedent, or within 30 days after coming into possession of property of decedent, by the following persons:

A. In the case of estates of resident decedents.—(1) By the surviving husband or wife, as the case may be, for one-half the value at the decedent's death, of community property owned by the decedent and the survivor.

(2) By the first taker after the decedent of any of decedent's real property where this passes, in accordance with local law, directly to the heirs of the decedent.

(3) By donees who have received within two years prior to the decedent's death any gift of material value from the decedent, or who have received at any time whatever gifts made by decedent in contemplation of, or intended to take legal effect at, death.

(4) By trustees holding property conveyed during his lifetime by the decedent in contemplation of death (or with the intent to provide for others than the decedent at or after decedent's death), regardless of the date of the instrument making the conveyance, or the date of possession by the trustee, or the date of vesting of the right of survivors to possession or enjoyment at or after decedent's death.

(5) By fiduciaries holding property of any kind jointly or in entirety for the decedent and another or others.

(6) By any other person holding or taking any property upon decedent's death which will not pass through the executor or administrator.

The notice should be filed with the collector for the district in which the decedent maintained his principal residence.

B. Estates of non-resident decedents.—All persons who at any time have received property from a non-

resident decedent as a gift in contemplation of death, and all persons, including beneficiaries, heirs, trustees and fiduciaries, who hold any property of a non-resident decedent physically located within the United States, shall file the notice (Form 705) with the collector, regardless of the amount of the property. The notice must be filed within 30 days from the decedent's death with the collector of the district in which the property is located. If the property is located in more than one district, the notice must be filed with the collector at Baltimore, Md. If information of a non-resident decedent's death is not received in time to enable the beneficiary to file the notice within the thirty-day period, no penalty for failure to file such notice will be imposed if the notice is filed within 30 days from the time information of decedent's death was received.

Return—Form 706.—Returns must be made as follows:

A. Resident decedent's estate.—In the case of estates having no executors or administrators, or where any part of the gross estate passes direct to a beneficiary, the law places upon the separate beneficiaries the precise duties with regard to filing of the return and payment of the tax that are otherwise imposed on executors. Where the property is held for the beneficiary by guardians, trustees, or fiduciaries, the return may be filed by such representatives.

Each beneficiary making return for any part of the estate is required to give full information regarding the estate, and the collector will compile a final and complete return from the several returns, if any, made by the beneficiaries and assess the tax accordingly.

B. Non-resident decedent's estate.—If the foreign executor has failed to file the return within one year from the date of decedent's death, the collector shall require the return to be made by a beneficiary. No deductions whatever may be taken upon such returns unless it is proved that all the non-resident's property

is located within the United States and is included in the gross estate on the return.

Under no circumstances may a beneficiary release to a foreign executor or administrator or foreign beneficiary of a non-resident decedent's estate any of decedent's property, until

(1) The amount of tax has been paid; or

(2) Ancillary letters have been taken out in the United States; or

(3) Provision has been made by the estate for the satisfaction of the tax lien resting upon decedent's property in this country.

When ancillary letters have been taken out, or provision made for the payment of the tax, the beneficiary should immediately notify the collector of such fact. A penalty will be imposed for failure to comply with these requirements.

Payment of tax.—Payment of the tax by the beneficiary is required only where he has filed a return, or released property of a non-resident decedent's estate to a foreign executor, administrator or beneficiary and withheld the amount of tax due.

It is very important for trustees to note that they are personally liable for the amount of any tax due and unpaid upon the value of decedent's interest in any property in their hands which had been transferred to them in trust at any time by the decedent, if such transfer was made by the decedent in contemplation of death. Such property, to the extent of decedent's interest therein, is subject to a lien for the amount of the tax.

DUTIES OF BANKING INSTITUTIONS AND SAFE DEPOSIT COMPANIES

Thirty-day notice—Form 705.—The thirty-day notice provisions apply as follows to the two classes of estates:

A. Resident decedent's estate.—Where the property of a resident decedent's estate is taken in charge by a duly appointed executor or administrator there is no obligation upon a bank or safe deposit company to file the notice or to see that the executor files the notice, and the bank or safe deposit company may safely release all funds and other property unto the executor or administrator. But, if the property held by the bank or safe deposit company is a joint account, or any other property which would not pass through the executor's hands, the primary duty of filing the notice is upon the bank or safe deposit company. If the bank or safe deposit company, however, depends upon the executor to file the notice for property, which does not come into his charge, it does so at its own risk. Unless the bank or safe deposit company is satisfied that the gross estate of the decedent is less than $60,000 or the net estate is less than $50,000, it should file the notice for its own protection and thus relieve itself from all liability.

B. Non-resident decedent's estates.—Where ancillary letters are taken out in the United States, and the property of a non-resident decedent in the possession of a bank or safe deposit company is taken in charge by the ancillary executor or administrator, there is no obligation upon a bank or safe deposit company to file the notice, and the property may safely be released to the ancillary representative. But if no such representative has qualified within thirty days after the death of a non-resident decedent or notice thereof, then the bank or safe deposit company should promptly file the notice (Form 705) with the collector, regardless of the amount of the property held, and retain such property in its custody.

Return—Form 706.—No return is required from a bank or safe deposit company where the property of the decedent has been delivered to a duly appointed executor or administrator, or where ancillary letters are

taken out in the United States, to an ancillary executor or administrator.

Where a bank or safe deposit company holds property of a resident decedent in a joint account, the collector will look either to the executor or to the succeeding owner, depending upon the circumstances in the particular case, for making the return.

In the case of a non-resident decedent, if the foreign executor has failed to file the return within one year from the date of decedent's death, the collector shall require return to be made by the bank or safe deposit company. No deductions whatever may be taken upon such return unless there is a showing that all the non-resident's property is located in the United States, and is included in the gross estate on the return.

Under no circumstances may a bank or safe deposit company release to a foreign executor or administrator or to a foreign beneficiary of the non-resident decedent any property within the United States at the time of decedent's death until either

(1) The tax due has been paid; or

(2) Ancillary letters have been taken out in the United States; or

(3) Provision has been made for the satisfaction of the tax lien resting upon decedent's property in the United States.

When ancillary letters have been granted, or provision made for the payment of the tax, full and complete notice thereof shall immediately be given to the collector. A penalty will be imposed for failure to comply with these requirements.

Payment of tax.—Payment of the tax by a bank or safe deposit company is only required where it has filed a return, or where it has released property of a non-resident decedent's estate to a foreign executor, administrator or beneficiary and withheld the amount of the tax due.

DUTIES OF AGENTS OR REPRESENTATIVES OF NON-RESIDENT DECEDENTS

Conditions of release to foreign administrator.—Under no circumstances may the local agent, representative, etc., release to a foreign administrator or executor or a foreign beneficiary of the decedent any property within the United States at the time of the decedent's death until either (1) the tax due has been paid, or (2) ancillary letters have been taken out in the United States, or (3) the retaining by the local representative of a sum sufficient to guarantee the payment of the entire tax that would be due. When ancillary letters have been taken out, or provision made for the payment of the tax, the local agent shall immediately inform the collector fully as to the facts (T. D. 2454).

The duties of agents or representatives of non-resident decedent's estates, with regard to the filing of the notice and the return, and the payment of the tax, are the same as those of banking institutions and safe deposit companies with respect to the estate of non-resident decedents. These duties are described in pages 401-403 of this chapter.

With relation to non-resident decedents, the thirty-day notice (Return Form 706) and tax payment are required of representatives in this country where no executor acts within the required time. An inquiry was made as to the liability, under Section 205, of representatives in this country of a non-resident decedent leaving property in the hands of representatives, and where, so far as the representatives knew, no executor had been appointed. Section 205 requires that the executor, within thirty days after qualifying as such, or after taking possession of any property of a decedent, whichever event first occurs, shall give notice to the Collector of Internal Revenue, and that later the executor shall file return of the estate. Section 207 re-

quires that the executor shall pay the tax to the collector or his deputy. In Section 200 the term "executor" is defined as meaning either the executor or administrator, or if there is none, any person who takes possession of any property of the deceased.

In this certain case it was argued that the representatives in this country of the non-resident decedent do not "take possession" of decedent's property, and that, since the representatives are neither administrators nor beneficiaries, they cannot be required to file the thirty-day notice, or return, or make payment of the tax.

From that view the Treasury Department dissented, for although there is no change of agent or representative, there was immediately upon the non-resident's death a complete change in the character of the agency. Prior to the death, the local representatives held the property in charge for the non-resident, but immediately the death occurred they held it subject to the order of executors or administrators, and for the beneficiaries legally entitled thereto. At the moment of death there was, on the part of the local representatives, an actual legal taking of possession for succeeding owners, a change in the conditions of possession so complete that no actuality would be added by the substitution of other agents.

It is clear, therefore, that such representatives are responsible for the filing of the thirty-day notice, and can be saved from that responsibility only if, prior to the expiration of thirty days from the death of the non-resident, the required notice (Form 704) has been filed by the executors or administrators.

Further weight is given to this contention by a consideration of the evident intent of Congress in its definition of the term "executor" (see Section 200 of Law). This definition was given with the sole purpose of providing effective means for the ascertainment and

collection of the tax due in every case where the complete facts might not be known to the executor or where the executor might be in a position successfully to evade his responsibilities under the Act.

The object on the part of Congress in causing "any person who takes possession of any property of the decedent" to share equally with executors and administrators the liability to render notice and return and to pay the tax, was that there should not be, under any circumstances of transmission, a failure of the administrative power to secure a full disclosure of the facts and a complete satisfaction of the tax. Congress must have foreseen, in enacting the final paragraph of Section 202,[1] that without such an administrative requirement as this the tax due, because of stock owned by a non-resident in domestic corporations, could be successfully evaded.

The definition of "executor" in Section 200 was made intentionally so broad that no property subject to the tax could escape taxation through any uncertainty as to the person liable for giving accurate information with regard thereto. In the case of a non-resident decedent, the appointment of a foreign executor or administrator will not relieve a person in control of property in the United States from these duties, unless and until he has made return and tendered payment of tax.

DUTIES OF CORPORATIONS AND THEIR TRANSFER AGENTS, REGISTERS OF BONDS AND PAYING AGENTS

Duties of corporate agents defined.—The following is an extract from Treasury Decision 2490, defining the duties of corporate transfer agents, registers of bonds and paying agents, and of corporations performing these duties themselves:

"(1) Where the transfer of stock or bonds or payment of dividends or interest theretofore the legal property of a decedent, whether a resident

[1] Section 202, subdivision (c).

or a non-resident, is made to or upon the order of an executor or administrator acting under letters granted in the United States, Hawaii, or Alaska, the corporate agent or officer will not be required to file the thirty-day notice, make return, or pay tax.

"(2) The thirty-day notice (Form 714) is required to be filed whenever a corporation, its transfer agent, register, or paying agent is called upon to make a transfer of stocks or bonds, or to pay interest or dividends to any person succeeding in right thereto [of] a stockholder or bondholder who, since September 8, 1916, has died domiciled outside the United States, Hawaii, or Alaska, unless such successor in interest is an executor or administrator of the non-resident decedent acting under letters granted within the United States, Hawaii, or Alaska.

"(3) This notice (Form 714) must be filed for dividends declared prior to the day of death and for interest payable after death to the extent of the portion accrued to the day of death.

"(4) If this notice (Form 714) be filed as required either within thirty days from death or immediately upon receipt of the order for transfer or payment, the transfer or payment need not be postponed. The collector, immediately upon receipt of the notice, will communicate with the foreign executor or succeeding party in interest, advising [him] of the requirements of the estate taxing act and furnishing blank Forms 706 for the making of the return. If, within the legal period, the tax is not paid, proceedings will be instituted under Section 208 of the taxing act for the sale of property and the satisfaction of the tax.

"(5) This regulation is promulgated in view of present international conditions, and is subject to revocation should it be demonstrated that the accommodation herein made to corporations and their agents result in insecurity of the revenue.[1] This regulation is not to be construed in any degree as modifying the interpretation hitherto given by the department of the term "executor" as used in Section 200 of the act of September 8, 1916."[2]

It should be noted that where the notice on Form 714 has been filed and stock formerly owned by a non-resident decedent has been transferred, that the lien for the tax can be enforced under provisions of Section 208 of the law whenever necessary to protect the Govern-

[1] That is to say, the Treasury Department reserves the right to hold up the transfer until either (1) the tax due has been paid, or (2) ancillary letters have been taken out in the United States, or (3) provision has been made for the satisfaction of the tax lien resting upon the non-resident decedent's property in the United States.

[2] In other words, the Treasury Department reserves the right, where necessary, to impose the duties and obligations of executors upon corporations and their transfer agents, registrars and paying agents, of filing the return and paying the tax.

ment, regardless of the possession of the stock by succeeding owners. Purchasers who acquire stock formerly registered in the name of a non-resident decedent may therefore find a lien for the amount of tax attached to their property if the stock was purchased from a person other than an ancillary executor or administrator. The purchaser may protect himself by insisting that the sellor first deposit with the collector such a sum as will fully satisfy the amount of tax, and, upon presentation of the collector's receipt, he may safely pay the purchase price of the stock.

RETURNS

General rules.—Under the various sections of this chapter defining the duties of representatives of a decedent's estate it has been stated under what conditions a return (Form 706) is required. In this section will be given the general rules, regulations and instructions regarding the contents of the return and the manner of filing.

Section 205 of the law provides that an executor shall file a return under oath, in duplicate, at such times and in such manner as may be required by the Commissioner of Internal Revenue. As the tax is due and payable one year after the decedent's death, the Treasury Department requires the return to be filed on or before that date.

A return is required of the estate of every resident decedent whose gross estate exceeds in value $60,000, or whose net estate has any value in excess of the specific exemption of $50,000.[1]

A return is required of the estate of every nonresident decedent owning property in the United States, including stocks of domestic corporations, even though the certificates were physically located outside

[1] For example: Gross estate $58,000, deductions $4,000, specific exemption $50,000, net estate $4,000. In this estate a return should be filed.

of the United States at the time of decedent's death. A return is also required if the decedent has at any time transferred any property in contemplation of death.[1]

Tentative and final returns.—The logical time for filing the return is coincident with the final settlement of the estate (where this occurs before the expiration of one year from decedent's death), as at that time the values of the gross estate and items of deductions may be accurately determined. Where the administration of the estate is unduly delayed and it is desired to take advantage of the discount allowed for prior payment of the tax, a tentative return will be accepted, provided reasonably accurate information is given of the gross estate, and of all items of deductions that have been actually determined (i. e., exclusive of estimated items). Where a tentative return has been filed within the year, a final return must, nevertheless, be made at the expiration of the year. If, at the expiration of the year, it is impossible to make the final return, the collector may, upon application, grant an extension not exceeding ninety days. If, at the expiration of ninety days, the cause for delay still exists and is unavoidable, the collector may extend the time for filing until the reasonable ground for delay has been removed. (T. D. 2637.)

Distribution or sale of personal effects.—As the Treasury Department desires to verify the accuracy of all returns, executors or other representatives of estates liable to tax are directed not to sell, dispose or distribute any article of furniture, jewelry, works of art

[1] Thus, if a non-resident decedent had assigned property to a resident trustee, under a trust agreement, providing for the payment of the income thereon to him (the decedent) for life, and after his death, the property to revert to his estate, or be otherwise disposed of, a return should be made by the executor or representative of the decedent's estate. If the return is not made this duty devolves upon the resident trustee, who must also pay the tax.

and other personal effects until the value thereof has been verified by a government agent. Arrangement may be made with the collector to have this done promptly.

Where to file.—If the decedent maintained more than one residence, his principal residence (actual domicile) determines the internal revenue district in which the return must be filed and tax paid.

If decedent was a non-resident and his sole property within the United States, Hawaii or Alaska was stocks or bonds of an American corporation, his return should be filed with the collector in whose district the head office of the corporation is located, unless the estate has a representative in the United States having the stocks or bonds in charge, in which case the return may be filed with the collector in whose district the representative has his office.

Description of real property.—In describing realty it may not be necessary to recite the whole description on the deed, but sufficient data should be given in each case to permit an immediate and exact location by a Government officer. For example: "W. ½, sec. 2, tp. 20, Madison, Ill."; or, "House and lot, 125, So. Main St., Auburn, N. Y."

Accrued income.—If accrued income has been reduced to cash prior to death and is included in "cash in bank" or otherwise accounted for on the return, it should not be set up in the income column.

Gifts in contemplation of death.—Under Item 2 there must be shown every gift or transfer of material value made or effected by decedent within two years prior to day of death. With the return may be submitted such evidence as the estate elects to submit showing whether the gift or transfer was made in contemplation of death, and the question of taxability will be ruled upon by the Commissioner before the assessment against the estate is confirmed. Every gift or transfer made in con-

templation of or intended to take effect at death must be returned, regardless of the date when made or effected.

Valuation of stocks and bonds.—The highest selling price of stocks and bonds on the day of death fixes the value to be returned; or if no sale, then the highest bid price. If the stocks or bonds are not listed on the market, the executor may set up, from the best evidence he possesses, a value that he deems the true value as of the day of decedent's death.

The Treasury Department has held that "the actual value of the real and personal estate of decedents on the date of death should be reported upon Form 706. The market value of securities as of the date of death is, of course, the proper value to be returned. If decedent died on Sunday or a legal holiday, the market value of the securities on the day preceding his death should be returned. In the absence of a sale on the date of death or day preceding, the highest bid price for the security in question is accepted as the market value. This, of course, refers to securities listed on a stock exchange or dealt in on the Curb. If the security whose market value is sought is not listed on a stock exchange or dealt in on the Curb, the fair market value may be computed from actual sales made during the year preceding the date of death. Sales to employees, sales for the purpose of qualifying directors or other officers, sales pursuant or subject to an agreement restricting the re-sale or free action of the purchaser and sales not made within one year preceding the date of death are not of a character that would justify their use in computing the value of corporate stock to the exclusion of any other evidence. If the stock is not listed on an exchange, and no record of any bona-fide sales has been made during the year preceding the date of decedent's death, the value of the stock should be computed upon the basis of the net profits of the corporation earned during the preceding five years.

"It has been found, upon examination of the returns of net income of a large number of different classes of corporations listed on an exchange, that they earn approximately the following rates in order to make their stock worth par:

	Per cent
Banking—States west of the Mississippi River	8
States east of the Mississippi River	6
Mercantile	10
Mining	10
Industrial	10
Oil-producing companies	15
Oil-refining companies	10
Public utilities and railroads	8

"The value of corporate stock of corporations which have no regular earnings, such as companies organized for the purpose of developing and selling timber land, mining property and other real property, and corporations which have earned no profits in the past five years, or have only been engaged in business one or two years, is not always determined from the earning capacity of the corporation. Therefore, the book value of such corporations is good evidence of the fair market value."

Community property.[1]—If the bulk of the estate is community property held in legal partnership by decedent and spouse, its value should not be shown under Item 4, but decedent's legal share should be returned under the several items, realty, stocks and bonds, and the like; otherwise the jointly owned property should be exactly described under Item 4.

Deductions.—No item of deductions can be taken in excess of an amount actually expended, or, if expended, in excess of the limit, if any, set upon such expenditure by the local laws under which the estate is being administered.

[1] For the meaning of this term see footnote, page 390.

Mortgages.—Mortgages resting on decedent's property should be shown under "Deductions," and the full value of the mortgaged realty should be shown under Item 1 of "Gross estate." A similar rule must be applied with regard to hypothecated personalty.

Losses.—It should be noted that deductible losses are strictly limited to those arising from fires, storms, shipwreck, or other casualty, and theft, when not compensated for, by insurance or otherwise. Losses sustained through sale or other disposition of property at less than the inventory value thereof at the date of decedent's death will not be allowed.

Non-resident's estate.—A non-resident's estate will show under items of the "Gross estate" only the gross estate within the United States, but will show under "Deductions" the entire legal deductions wherever incurred. It will then show in the space subjoined to "Recapitulation" the whole gross estate wherever situated and compute in accordance with Article XXIII of Regulations No. 37, revised May, 1917, the allowable share of total deductions.

Discount allowed for payment of tax within one year.—In order to compute the 5 per cent. per annum discount on estate tax paid within one year after the death of decedent, determine, first, the date when the payment will actually be placed in the collector's hands, then count the actual number of days from this day to and including the day when the tax is due. For example: Date of death, March 3, 1917, payment made Sept. 12, 1917; there would be 18 days remaining in September, October 31, November 30, December 31, January 31, February 28, and three days in March, 1918, the due date, making a total of 172 days for which discount is allowable. The discount on $1 for 172 days at 5 per cent is $0.0235616 (see table, page 415); multiply the gross tax by this amount, and the amount of discount will be the result.

(Extracts from T. D. 2497)

Instructions, with Tables, Relating to the Computation of the 5 Per Centum Discount to be Allowed on Estate Tax When Paid Before One Year After the Death of Decedent.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., June 4, 1917.

TO COLLECTORS OF INTERNAL REVENUE:

Numerous inquiries have been addressed to the bureau relative to the method of computing the 5 per cent. discount allowable on estate taxes where said taxes are paid in less than one year after the death of the decedent, as to accepting partial payments of estate taxes based on tentative returns.

Tables showing the discount on $1 from 1 to 364 days have, therefore, been prepared and are hereto appended. Collectors and others concerned in computing the discount should use these tables exclusively. Care should be taken to determine the number of days remaining in the month during which payment is made and count forward actual days until due date. For example: Date of death, March 4, 1917, payment made September 13, 1917; there would be 17 days remaining in September, October 31, November 30, December 31, January 31, February 28, and four days in March, the due date, making a total of 172 days for which discount is allowable.

Now, in computing the discount, find in the table the discount on $1 for 172 days and multiply the gross tax by this. The result will be the discount allowable, which, deducted from the full gross tax, will give the amount of tax on the date payment is made.

Executors in computing discount will use as the date of payment the date when said payment will actually be placed in the collector's hands, as the statute fixes

that as the date of payment regardless of the date of remittance or mailing.

Frequently, executors will file a return and request the collector to advise them of the amount of tax due, less discount. In such cases, the collector should compute the discount to some future date, advising the executor of the amount necessary to satisfy the tax on the date named, making it clear that the computation is based on the presumption that the money will be in his (the collector's) hands on that date.

Again, executors file a tentative return and ask permission to make a partial payment of the tax due, usually specifying a certain amount, provided the discount on this amount is allowed.

The department sees no objection to collectors accepting such partial payments. Care should be taken, however, to compute the present worth of such payments in order to determine how much of the tax is discharged. The computation in such case should be filed with the tentative return in order that when a complete or final return is filed the balance of the tax due can readily be determined. The present worth may readily be found by use of the table as follows: From $1 deduct the amount of discount on $1 from date of payment to due date. Divide the amount of tax paid by this remainder, and the quotient will be the present worth of the amount of tax liability discharged.

For example, a partial payment of $300,000 is tendered 278 days before due date. By the table 5 per cent. discount on $1 for 278 days is found to be $0.0380821; $1 less $0.0380821 leaves $0.9619179; $300,000 divided by $0.9619179 equals $311,876.82, the present worth or the amount of tax liability discharged by the partial payment.

David A. Gates,

Acting Commissioner of Internal Revenue.

5 PER CENT DISCOUNT ON $1, 1 DAY TO 364 DAYS

Days	Discount	Days	Discount	Days	Discount	Days	Discount
1	$0.0001369	50	$0.0068493	99	$0.0135616	148	$0.0202739
2	.0002739	51	.0069863	100	.0136986	149	.0204109
3	.0004109	52	.0071232	101	.0138356	150	.0205479
4	.0005479	53	.0072602	102	.0139726	151	.0206849
5	.0006849	54	.0073972	103	.0141095	152	.0208219
6	.0008219	55	.0075342	104	.0142465	153	.0209589
7	.0009589	56	.0076712	105	.0143835	154	.0210958
8	.0010958	57	.0078082	106	.0145205	155	.0212328
9	.0012328	58	.0079452	107	.0146575	156	.0213698
10	.0013698	59	.0080821	108	.0147945	157	.0215068
11	.0015068	60	.0082191	109	.0149315	158	.0216438
12	.0016438	61	.0083561	110	.0150684	159	.0217808
13	.0017808	62	.0084931	111	.0152054	160	.0219178
14	.0019178	63	.0086301	112	.0153424	161	.0220547
15	.0020547	64	.0087671	113	.0154794	162	.0221917
16	.0021917	65	.0089041	114	.0156164	163	.0223287
17	.0023287	66	.0090410	115	.0157534	164	.0224657
18	.0024657	67	.0091780	116	.0158904	165	.0226027
19	.0026027	68	.0093150	117	.0160273	166	.0227397
20	.0027397	69	.0094520	118	.0161643	167	.0228767
21	.0028767	70	.0095890	119	.0163013	168	.0230136
22	.0030136	71	.0097260	120	.0164383	169	.0231506
23	.0031506	72	.0098630	121	.0165753	170	.0232876
24	.0032876	73	.0100000	122	.0167123	171	.0234246
25	.0034246	74	.0101369	123	.0168493	172	.0235616
26	.0035616	75	.0102739	124	.0169863	173	.0236986
27	.0036986	76	.0104109	125	.0171232	174	.0238356
28	.0038356	77	.0105479	126	.0172602	175	.0239726
29	.0039726	78	.0106849	127	.0173972	176	.0241095
30	.0041095	79	.0108219	128	.0175342	177	.0242465
31	.0042465	80	.0109589	129	.0176712	178	.0243835
32	.0043835	81	.0110958	130	.0178082	179	.0245205
33	.0045205	82	.0112328	131	.0179452	180	.0246575
34	.0046575	83	.0113698	132	.0180821	181	.0247945
35	.0047945	84	.0115068	133	.0182191	182	.0249315
36	.0049315	85	.0116438	134	.0183561	183	.0250684
37	.0050684	86	.0117808	135	.0184931	184	.0252054
38	.0052054	87	.0119178	136	.0186301	185	.0253424
39	.0053424	88	.0120547	137	.0187671	186	.0254794
40	.0054794	89	.0121917	138	.0189041	187	.0256164
41	.0056164	90	.0123287	139	.0190410	188	.0257534
42	.0057534	91	.0124657	140	.0191780	189	.0258904
43	.0058904	92	.0126027	141	.0193150	190	.0260273
44	.0060273	93	.0127397	142	.0194520	191	.0261643
45	.0061643	94	.0128767	143	.0195890	192	.0263013
46	.0063013	95	.0130136	144	.0197260	193	.0264383
47	.0064383	96	.0131506	145	.0198630	194	.0265753
48	.0065753	97	.0132876	146	.0200000	195	.0267123
49	.0067123	98	.0134246	147	.0201369	196	.0268493

5 PER CENT DISCOUNT ON $1, 1 DAY TO 364 DAYS—*Continued*

Days	Discount	Days	Discount	Days	Discount	Days	Discount
197	$0.0269863	239	$0.0327397	281	$0.0384931	323	$0.0442465
198	.0271232	240	.0328767	282	.0386301	324	.0443835
199	.0272602	241	.0330136	283	.0387671	325	.0445205
200	.0273972	242	.0331506	284	.0389041	326	.0446575
201	.0275342	243	.0332876	285	.0390410	327	.0447945
202	.0276712	244	.0334246	286	.0391780	328	.0449315
203	.0278082	245	.0335616	287	.0393150	329	.0450684
204	.0279452	246	.0336986	288	.0394520	330	.0452054
205	.0280821	247	.0338356	289	.0395890	331	.0453424
206	.0282191	248	.0339726	290	.0397260	332	.0454794
207	.0283561	249	.0341095	291	.0398630	333	.0456164
208	.0284931	250	.0342465	292	.0400000	334	.0457534
209	.0286301	251	.0343835	293	.0401369	335	.0458904
210	.0287671	252	.0345205	294	.0402739	336	.0460273
211	.0289041	253	.0346575	295	.0404109	337	.0461643
212	.0290410	254	.0347945	296	.0405479	338	.0463013
213	.0291780	255	.0349315	297	.0406849	339	.0464383
214	.0293150	256	.0350684	298	.0408219	340	.0465753
215	.0294520	257	.0352054	299	.0409589	341	.0467123
216	.0295890	258	.0353424	300	.0410958	342	.0468493
217	.0297260	259	.0354794	301	.0412328	343	.0469863
218	.0298630	260	.0356164	302	.0413698	344	.0471232
219	.0300000	261	.0357534	303	.0415068	345	.0472602
220	.0301369	262	.0358904	304	.0416438	346	.0473972
221	.0302739	263	.0360273	305	.0417808	347	.0475342
222	.0304109	264	.0361643	306	.0419178	348	.0476712
223	.0305479	265	.0363013	307	.0420547	349	.0478082
224	.0306849	266	.0364383	308	.0421917	350	.0479452
225	.0308219	267	.0365753	309	.0423287	351	.0480821
226	.0309589	268	.0367123	310	.0424657	352	.0482191
227	.0310958	269	.0368493	311	.0426027	353	.0483561
228	.0312328	270	.0369863	312	.0427397	354	.0484931
229	.0313698	271	.0371232	313	.0428767	355	.0486301
230	.0315068	272	.0372602	314	.0430136	356	.0487671
231	.0316438	273	.0373972	315	.0431506	357	.0489041
232	.0317808	274	.0375342	316	.0432876	358	.0490410
233	.0319178	275	.0376712	317	.0434246	359	.0491780
234	.0320547	276	.0378082	318	.0435616	360	.0493150
235	.0321917	277	.0379452	319	.0436986	361	.0494520
236	.0323287	278	.0380821	320	.0438356	362	.0495890
237	.0324657	279	.0382191	321	.0439726	363	.0497260
238	.0326027	280	.0383561	322	.0441095	364	.0498630

Affidavit.—In the affidavit show whether the return submitted is tentative or final, by crossing out the inapplicable word.

When return and payment of tax is due.—The return and tax payment must be in the *collector's hands* before the year from the day of death has expired.

Signature.—The return should be signed and sworn to by all the executors.

RATES OF TAX

How tax rate is determined.—The application of the rates given below depends upon the date of decedent's death. The rates specified in the original act, passed September 8, 1916, are computed upon the net estate of every decedent dying on and after September 9, 1916, to and including March 2, 1917; the rates provided in the Amendment of March 3, 1917, apply to the net estate of every decedent dying on and after March 3, 1917, to and including October 3, 1917; and the rates provided in the Amendment of October 3, 1917, apply to the net estate of every decedent dying on and after October 4, 1917 (T. D. 2535).

Exemptions.—The Amendment of October 3, 1917, exempts from the additional tax imposed by Title 9 therein, the transfer of the net estate of any decedent dying while serving in the military or naval forces of the United States during the present war. If death results from injuries received or disease contracted in such service, within one year after the termination of the war, the same exemption applies. The effect of this exemption results in subjecting the net estates of military and naval decedents to rates imposed in the act of March 3, 1917.

RATE OF TAXATION UPON NET ESTATES

		Date of Death: Sept. 9, 1916, to Mar. 2, 1917, Inclusive	Date of Death: Mar. 3, 1917, to Oct. 3, 1917, Inclusive	Date of Death: On and After Oct. 4, 1917
Net estate not exceeding	$50,000 @..	1%	1½%	2%
Net estate $50,000—	150,000 @..	2%	3%	4%
Net estate 150,000—	250,000 @..	3%	4½%	6%
Net estate 250,000—	450,000 @..	4%	6%	8%
Net estate 450,000—	1,000,000 @..	5%	7½%	10%
Net estate 1,000,000—	2,000,000 @..	6%	9%	12%
Net estate 2,000,000—	3,000,000 @..	7%	10½%	14%
Net estate 3,000,000—	4,000,000 @..	8%	12%	16%
Net estate 4,000,000—	5,000,000 @..	9%	13½%	18%
Net estate 5,000,000—	8,000,000 @..	10%	15%	20%
Net estate 8,000,000—	10,000,000 @..	10%	15%	22%
Net estate exceeding	10,000,000 @..	10%	15%	25%

PAYMENT OF TAX

Conditions relating to tax payment.—The amount of the tax is based on the return (Form 706). The tax is due and payable one year after the decedent's death. If the tax is not paid within ninety days thereafter, interest is added at the rate of 10 per cent. per annum from the time of decedent's death, unless, because of claims against the estate, necessary litigation or other unavoidable delay, the collector finds that the tax cannot be determined, in which case interest is added at the rate of 6 per cent. per annum from the time of decedent's death until the cause for delay is removed, and thereafter at the rate of 10 per cent. per annum.

Procedure in collection when no return has been filed.—If, at the expiration of ninety days after one year from decedent's death, no complete and final return has been made, the collector will require a return to be made in such manner that the tax shown to be due thereon will satisfy, in the collector's opinion, all the tax the estate will be required by law to pay. If the amount of tax

paid exceeds the amount of tax as finally determined, the Commissioner will refund the excess. If the amount paid is less than the amount finally determined, the Commissioner will notify the executor of the amount of such excess, and interest will be added from the time of notification to the date of payment at the rate of 10 per cent per annum.

Discount for prepayment.—If the tax is paid before it is due (one year after decedent's death) a discount may be deducted at the rate of 5 per cent. per annum calculated from the time the payment is made (i. e., when actually received by the collector) to the date when the tax is due.

Advance payment of tax in an estimated lump amount will not be accepted. The initial tax payment must be based upon a return (either tentative or final) (see "returns," page 408 of this chapter), showing reasonably complete and accurate figures for every item of gross estate and deductions.

Suit for collection of tax.—As stated above, the tax is due one year after decedent's death, and if not paid within ninety days thereafter interest will be added from the day of decedent's death. If, however, the tax is not paid within 60 days after it is due, the collector shall, unless there is reasonable cause for further delay, bring suit for collection, and, upon decree, sell the property and satisfy the tax and expenses.

Tax is a lien upon estate.—The tax shown to be due upon a final return is a lien for ten years, or until sooner paid, upon the entire gross estate, except such part as is used for the payment of charges and expenses of administration. The lien follows the property into the hands of distributees and bona fide purchasers for value. If, after the tax has been paid upon a return and accepted by the commissioner as final, it later appears that an additional tax is due, the lien for the additional tax rests upon the property in the hands of

decedent's executors or beneficiaries, and does not rest upon any part of decedent's property which may have been sold to a bona fide purchaser.

A lien for the amount of the tax rests also upon the value of testator's interest in any property transferred by him in trust at any time to a trustee in contemplation of death.

PENALTIES

Penalty for neglect. — Any executor, administrator, beneficiary, heir, donee, transferee, trustee, fiduciary, banking institution, safe deposit company, paying agent, transfer agent, register, or other agent or representative of a decedent's estate who shall fail to file the notice (Forms 704, 705 and 714, as the case may be), or the return (Form 706), when required, shall be liable to a fine not to exceed $500, to be recovered, with costs of suit, in a civil action in the name of the United States. A similar penalty is likewise imposed upon anyone refusing to exhibit any record, file or paper containing or supposed to contain information concerning a decedent's estate upon the request of the commissioner, or his duly authorized agent.

Penalty for fraud.—Anyone knowingly making a false statement in any notice or return required to be filed shall be liable to a penalty of not exceeding $5,000, or imprisonment not exceeding one year, or both, in the discretion of the court.

CHAPTER XVII

ESTATE TAX LAW

BEING TITLE II OF "AN ACT TO INCREASE THE REVENUE AND FOR OTHER PURPOSES," APPROVED SEPTEMBER 8, 1916 (PUBLIC—No. 271—64th CONGRESS) IN EFFECT SEPTEMBER 9, 1916

TITLE II.—ESTATE TAX.

Definition.—Sec. 200. That when used in this title—

The term "person" includes partnerships, corporations, and associations;

The term "United States" means only the States, the Territories of Alaska and Hawaii, and the District of Columbia;

The term "executor" means the executor or administrator of the decedent, or, if there is no executor or administrator, any person who takes possession of any property of the decedent; and

The term "collector" means the collector of internal revenue of the district in which was the domicile of the decedent at the time of his death, or, if there was no such domicile in the United States, then the collector of the district in which is situated the part of the gross estate of the decedent in the United States, or, if such part of the gross estate is situated in more than one district, then the collector of internal revenue at Baltimore, Maryland.

Rate of tax.—Sec. 201. That a tax (hereinafter in this title referred to as the tax), equal to the following percentages of the value of the net estate, to be determined as provided in section two hundred and three, is hereby imposed upon the transfer of the net estate of every decedent dying after the passage of this Act, whether a resident or non-resident of the United States:

One per centum of the amount of such net estate not in excess of $50,000;

Two per centum of the amount by which such net estate exceeds $50,000 and does not exceed $150,000;

Three per centum of the amount by which such net estate exceeds $150,000 and does not exceed $250,000;

Four per centum of the amount by which such net estate exceeds $250,000 and does not exceed $450,000;

Five per centum of the amount by which such net estate exceeds $450,000 and does not exceed $1,000,000;

Six per centum of the amount by which such net estate exceeds $1,000,000 and does not exceed $2,000,000;

Seven per centum of the amount by which such net estate exceeds $2,000,000 and does not exceed $3,000,000;

Eight per centum of the amount by which such net estate exceeds $3,000,000 and does not exceed $4,000,000;

Nine per centum of the amount by which such net estate exceeds $4,000,000 and does not exceed $5,000,000; and

Ten per centum of the amount by which such net estate exceeds $5,000,000.

Valuation of gross estate.—Sec. 202. That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated:

(*a*) To the extent of the interest therein of the decedent at the time of his death which after his death is subject to the payment of the charges against his

estate and the expenses of its administration and is subject to distribution as part of his estate.

Transfers of property made in contemplation of death.—(b) To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death, except in case of a bona fide sale for a fair consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such a consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this title; and

Joint interests held by decedent and others.—(*c*) To the extent of the interest therein held jointly or as tenants in the entirety by the decedent and any other person, or deposited in banks or other institutions in their joint names and payable to either or the survivor; except such part thereof as may be shown to have originally belonged to such other person and never to have belonged to the decedent.

Disposition of stock in domestic corporations owned by decedent.—For the purpose of this title stock in a domestic corporation owned and held by a non-resident decedent shall be deemed property within the United States, and any property of which the decedent has made a transfer or with respect to which he has created a trust, within the meaning of subdivision (*b*) of this section, shall be deemed to be situated in the United States, if so situated either at the time of the transfer or the creation of the trust, or at the time of the decedent's death.

Valuation of net estate.—Sec. 203. That for the purpose of the tax the value of the net estate shall be determined—

(a) In the case of a resident, by deducting from the value of the gross estate—

(1) Such amounts for funeral expenses, administration expenses, claims against the estate, unpaid mortgages, losses incurred during the settlement of the estate arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise, support during the settlement of the estate of those dependent upon the decedent, and such other charges against the estate, as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered; and

(2) An exemption of $50,000;

(b) In the case of a non-resident, by deducting from the value of that part of his gross estate which at the time of his death is situated in the United States that proportion of the deductions specified in paragraph (1) of subdivision (a) of this section which the value of such part bears to the value of his entire gross estate, wherever situated. But no deductions shall be allowed in the case of a non-resident unless the executor includes in the return required to be filed under section two hundred and five the value at the time of his death of that part of the gross estate of the non-resident not situated in the United States.

Date tax becomes due.—Sec. 204. That the tax shall be due one year after the decedent's death. If the tax is paid before it is due a discount at the rate of five per centum per annum, calculated from the time payment is made to the date when the tax is due, shall be deducted. If the tax is not paid within ninety days after it is due interest at the rate of ten per centum per annum from the time of the decedent's death shall be added as part of the tax, unless because of claims against the estate, necessary litigation, or other unavoidable delay the collector finds that the tax can not

be determined, in which case the interest shall be at the rate of six per centum per annum from the time of the decedent's death until the cause of such delay is removed, and thereafter at the rate of ten per centum per annum. Litigation to defeat the payment of the tax shall not be deemed necessary litigation.

Executor to qualify and file return.—Sec. 205. That the executor, within thirty days after qualifying as such, or after coming into possession of any property of the decedent, whichever event first occurs, shall give written notice thereof to the collector. The executor shall also, at such times and in such manner as may be required by the regulations made under this title, file with the collector a return under oath in duplicate, setting forth (a) the value of the gross estate of the decedent at the time of his death, or, in case of a non-resident, of that part of his gross estate situated in the United States; (*b*) the deductions allowed under section two hundred and three; (*c*) the value of the net estate of the decedent as defined in section two hundred and three; and (*d*) the tax paid or payable thereon; or such part of such information as may at the time be ascertainable and such supplemental data as may be necessary to establish the correct tax. Return shall be made in all cases of estates subject to the tax or where the gross estate at the death of the decedent exceeds $60,000, and in the case of the estate of every non-resident any part of whose gross estate is situated in the United States. If the executor is unable to make a complete return as to any part of the gross estate of the decedent, he shall include in his return a description of such part and the name of every person holding a legal or beneficial interest therein, and upon notice from the collector such person shall in like manner make a return as to such part of the gross estate. The Commissioner of Internal Revenue shall make all assessments of the tax under the author-

ity of existing administrative special and general provisions of law relating to the assessment and collection of taxes.

Cases in which collector shall make return.—Sec. 206. That if no administration is granted upon the estate of a decedent, or if no return is filed as provided in section two hundred and five, or if a return contains a false or incorrect statement of a material fact, the collector or deputy collector shall make a return and the Commissioner of Internal Revenue shall assess the tax thereon.

Procedure in tax payment.—Sec. 207. That the executor shall pay the tax to the collector or deputy collector. If for any reason the amount of the tax can not be determined, the payment of a sum of money sufficient, in the opinion of the collector, to discharge the tax shall be deemed payment in full of the tax, except as in this section otherwise provided. If the amount so paid exceeds the amount of the tax as finally determined, the Commissioner of Internal Revenue shall refund such excess to the executor. If the amount of the tax as finally determined exceeds the amount so paid the commissioner shall notify the executor of the amount of such excess. From the time of such notification to the time of the final payment of such excess part of the tax, interest shall be added thereto at the rate of ten per centum per annum, and the amount of such excess shall be a lien upon the entire gross estate, except such part thereof as may have been sold to a bona fide purchaser for a fair consideration in money or money's worth.

The collector shall grant to the person paying the tax duplicate receipts, either of which shall be sufficient evidence of such payment, and shall entitle the executor to be credited and allowed the amount thereof by any court having jurisdiction to audit or settle his accounts.

Collection by sale of property in case of default.—Sec. 208. That if the tax herein imposed is not paid within sixty days after it is due, the collector shall, unless there is reasonable cause for further delay, commence appropriate proceedings in any court of the United States, in the name of the United States, to subject the property of the decedent to be sold under the judgment or decree of the court. From the proceeds of such sale the amount of the tax, together with the costs and expenses of every description to be allowed by the court, shall be first paid, and the balance shall be deposited according to the order of the court, to be paid under its direction to the person entitled thereto. If the tax or any part thereof is paid by, or collected out of that part of the estate passing to or in the possession of, any person other than the executor in his capacity as such, such person shall be entitled to reimbursement out of any part of the estate still undistributed or by a just and equitable contribution by the persons whose interest in the estate of the decedent would have been reduced if the tax had been paid before the distribution of the estate or whose interest is subject to equal or prior liability for the payment of taxes, debts, or other charges against the estate, it being the purpose and intent of this title that so far as is practicable and unless otherwise directed by the will of the decedent the tax shall be paid out of the estate before its distribution.

Tax is a lien against decedent's gross estate.—Sec. 209. That unless the tax is sooner paid in full, it shall be a lien for ten years upon the gross estate of the decedent, except that such part of the gross estate as is used for the payment of charges against the estate and expenses of its administration, allowed by any court having jurisdiction thereof, shall be divested of such lien.

If the decedent makes a transfer of, or creates a trust with respect to, any property in contemplation of or in-

tended to take effect in possession or enjoyment at or after his death (except in the case of a bona fide sale for a fair consideration in money or money's worth) and if the tax in respect thereto is not paid when due, the transferee or trustee shall be personally liable for such tax, and such property, to the extent of the decedent's interest therein at the time of such transfer, shall be subject to a like lien equal to the amount of such tax. Any part of such property sold by such transferee or trustee to a bona fide purchaser for a fair consideration in money or money's worth shall be divested of the lien and a like lien shall then attach to all the property of such transferee or trustee, except any part sold to a bona fide purchaser for a fair consideration in money or money's worth.

Penalties for false statement and for withholding information.—Sec. 210. That whoever knowingly makes any false statement in any notice or return required to be filed by this title shall be liable to a penalty of not exceeding $5,000, or imprisonment not exceeding one year, or both, in the discretion of the court.

Whoever fails to comply with any duty imposed upon him by section two hundred and five, or, having in his possession or control any record, file, or paper, containing or supposed to contain any information concerning the estate of the decedent, fails to exhibit the same upon request to the Commissioner of Internal Revenue or any collector or law officer of the United States, or his duly authorized deputy or agent, who desires to examine the same in the performance of his duties under this title, shall be liable to a penalty of not exceeding $500, to be recovered, with costs of suit, in a civil action in the name of the United States.

Administration of law.—Sec. 211. That all administrative, special, and general provisions of law, including the laws in relation to the assessment and collection of taxes, not heretofore specifically repealed are hereby

made to apply to this title so far as applicable and not inconsistent with its provisions.

Sec. 212. That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall make such regulations, and prescribe and require the use of such books and forms, as he may deem necessary to carry out the provisions of this title.

TITLE IX.

Invalidating clause.—Sec. 900. That if any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of said Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered.

When Act takes effect—conflicting Acts repealed.—Sec. 902. That unless otherwise herein specially provided this Act shall take effect on the day following its passage, and all provisions of any Act or Acts inconsistent with the provisions of this Act, are hereby repealed.

Approved by the President, September 8, 1916.

TITLE IX.—WAR ESTATE TAX.[1]

Rate of tax upon transfer of decedent's estate.—Sec. 900 [of the general revenue Act of which this Title is a part]. That in addition to the tax imposed by section two hundred and one of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, as amended.

[1] War Estate Tax. Being Title IX of "An Act to Provide Revenue to Defray War Expenses and for other Purposes," Approved October 3, 1917. (Public—No. 50—65th Congress.) In effect October 4, 1917, unless otherwise specially provided.

(a) A tax equal to the following percentages of its value is hereby imposed upon the transfer of each net estate of every decedent dying after the passage of this Act, the transfer of which is taxable under such section (the value of such net estate to be determined as provided in Title II of such Act of September eighth, nineteen hundred and sixteen):

One-half of one per centum of the amount of such net estate not in excess of $50,000;

One per centum of the amount by which such net estate exceeds $50,000 and does not exceed $150,000;

One and one-half per centum of the amount by which such net estate exceeds $150,000 and does not exceed $250,000;

Two per centum of the amount by which such net estate exceeds $250,000 and does not exceed $450,000;

Two and one-half per centum of the amount by which such net estate exceeds $450,000 and does not exceed $1,000,000;

Three per centum of the amount by which such net estate exceeds $1,000,000 and does not exceed $2,000,000;

Three and one-half per centum of the amount by which such net estate exceeds $2,000,000 and does not exceed $3,000,000;

Four per centum of the amount by which such net estate exceeds $3,000,000 and does not exceed $4,000,000;

Four and one-half per centum of the amount by which such net estate exceeds $4,000,000 and does not exceed $5,000,000;

Five per centum of the amount by which such net estate exceeds $5,000,000 and does not exceed $8,000,000;

Seven per centum of the amount by which such net estate exceeds $8,000,000 and does not exceed $10,000,000; and

Ten per centum of the amount by which such net estate exceeds $10,000,000.

Estate of soldiers and marines exempt.—Sec. 901. That the tax imposed by this title shall not apply to the transfer of the net estate of any decedent dying while serving in the military or naval forces of the United States, during the continuance of the war in which the United States is now engaged, or if death results from injuries received or disease contracted in such service, within one year after the termination of such war. For the purposes of this section the termination of the war shall be evidenced by the proclamation of the President.

Approved by the President, October 3, 1917.

Taxability of United States Bonds, Treasury Certificates of Indebtedness and War Saving Certificates Issued Under Authority of Act of September 24, 1917.

TITLE III.—ESTATE TAX.[1]

Sec. 300 [of the general revenue Act of which this Title is a part]. That section two hundred and one, Title II, of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, be, and the same is hereby, amended to read as follows:

"Sec. 201. That a tax (hereinafter in this title referred to as the tax), equal to the following percentages of the value of the net estate, to be determined as provided in section two hundred and three, is hereby imposed upon the transfer of the net estate of every decedent dying after the passage of this Act, whether a resident or non-resident of the United States:

"One and one-half per centum of the amount of such net estate not in excess of $50,000;

[1] Amendment Number I. Being Title III of "An Act to Provide Increased Revenue to Defray the Expenses of the Increased Appropriations for the Army and Navy and the Extensions of Fortifications, and for Other Purposes," Approved March 3, 1917. (Public—No. 377—64th Congress.) In effect March 3, 1917.

"Three per centum of the amount by which such net estate exceeds $50,000 and does not exceed $150,000;

"Four and one-half per centum of the amount by which such net estate exceeds $150,000 and does not exceed $250,000;

"Six per centum of the amount by which such net estate exceeds $250,000 and does not exceed $450,000;

"Seven and one-half per centum of the amount by which such net estate exceeds $450,000 and does not exceed $1,000,000;

"Nine per centum of the amount by which such net estate exceeds $1,000,000 and does not exceed $2,000,000;

"Ten and one-half per centum of the amount by which such net estate exceeds $2,000,000 and does not exceed $3,000,000;

"Twelve per centum of the amount by which such net estate exceeds $3,000,000 and does not exceed $4,000,000;

"Thirteen and one-half per centum of the amount by which such net estate exceeds $4,000,000 and does not exceed $5,000,000; and

"Fifteen per centum of the amount by which such net estate exceeds $5,000,000."

Sec. 301. That the tax on the transfer of the net estate of decedents dying between September eighth, nineteen hundred and sixteen, and the passage of this Act shall be computed at the rates originally prescribed in the Act approved September eighth, nineteen hundred and sixteen.

Approved by the President, March 3, 1917.

CHAPTER XVIII

MUNITION MANUFACTURER'S TAX

Origin of Munition Manufacturer's Tax.—The Munition Manufacturer's Tax is Title III of "An Act to Increase the Revenue and for Other Purposes," approved September 8, 1916. Its original purpose was to place an excise tax on the profits derived from the manufacture and sale of certain munitions and munitions parts manufactured in the United States and sold to foreign governments. A ruling has been made, however, that the tax applies also to profits from the manufacture and sale of munitions sold to the United States or to any other purchaser for other than industrial purposes.

Time during which law is effective.—The law became effective September 9, 1916, but was retroactive to January 1, 1916, the first taxable year being the twelve months ended December 31, 1916. It was provided (section 301, subdivision [2]) that the tax should cease to be of effect one year after the termination of the present European war, but this provision was changed by an amendment inserted in the Act of October 3, 1917, which specifies January 1, 1918, as the date upon which the tax shall terminate.

Manufacturer pays the tax.—The tax is to be paid by every person manufacturing within the United States any of the articles enumerated in section 301, "person" including, under Title III, partnerships, corporations and associations, and "United States" meaning only the States, the Territories of Alaska and Hawaii and the District of Columbia. It is to be noted that

the tax is only upon the manufacturer or his agent and not upon dealers or brokers unless they are agents of the manufacturer, since the tax on any article is payable only once.

In the case of a business which ceases during a calendar year, the tax will be assessed against the person who owned or carried on the business at the time it ceased, or against his agent, if he had an agent, carrying on the business. In either case the person against whom the tax is assessed will be held liable for its payment and to any penalties that may attach to his failure to comply with the provisions of the law.

Assemblage of parts is construed as manufacture.—The Commissioner of Internal Revenue, in a letter dated January 18, 1917, holds that a manufacturer of munitions, under the Munitions Tax Law, includes one who collects the parts, whether complete or partially complete, and, by assembling such parts, constructs a finished and completed article ready for use, and that the net profits from the sale by him of the munitions so manufactured will be subject to the tax imposed by this title.

Basis of the tax.—The basis of the tax is the entire net profits actually received and accrued from the sale or disposition of such articles manufactured within the United States from January 1, 1916, to January 1, 1918. Profits received subsequently on contracts completed before January 1, 1916, are not included. In the case of contracts only partially performed at that date, the tax attaches upon all the profits resulting from such contract received after January 1, 1916.

Rate of tax.—The rate of tax under the original Act was 12½ per cent, which rate applied in 1916. The rate for the tax collectible on profits returned in 1917, however, is 10 per cent, as provided in the amendment of October 3, 1917.

The changes in the law, reducing the rate and pro-

viding for the termination of the tax January 1, 1918, were made as a result of (1) the new conditions due to the participation of the United States in the war and (2) the imposition of the War Excess Profits Tax.

Computation of Tax.—From the foregoing general summary it will be seen that the tax is a given percentage of net profits derived from the manufacture and sale of certain articles during a specified period of time. The problem of computing the tax due in any specific case, accordingly, resolves itself into a determination of (1) what articles are taxable; (2) what deductions may be allowed from gross income received from the manufacture and sale of those articles in order to ascertain the taxable net profits and (3) what rate of tax applies during the period in which they were produced and sold, together with a determination of the actual time at which a contract has been completed and the profits therefrom accordingly (1) exempt, (2) subject to 12½ per cent tax (3) 10 per cent tax, or again exempt, due to the expiration of the taxable period, which ends January 1, 1918.

These separate phases of the problem of computing the actual amount of tax payable will be considered in the following pages of this chapter.

Articles the net profit derived from the manufacture and sale of which is taxable.—The articles enumerated in section 301, the net profit derived from the manufacture and sale or disposition of which is taxable, will hereafter, for convenience, be referred to as "taxable articles," and "exempt" will mean that the manufacturer of such articles will not be held liable for the tax. In the following sections, the above referred to "taxable articles" will be defined where necessary and such information given concerning them as will enable the manufacturer of the same or a similar article to determine whether or not he is liable for the payment of a munition manufacturer's tax.

References given herein, as "Art. 14" below, are to articles of Treasury Department Regulations 39.

Exemption of articles made for industrial purposes.—Articles enumerated in (a) and (b) of Section 301, and otherwise taxable, are exempt if used for an industrial purpose. Articles sold to the general trade, for sporting purposes, commercial purposes, or other purposes not strictly industrial, are not exempt. "Used for industrial purposes" means "used in connection with or in the promotion of some industry." (Art. 14.)

Definition of "part."—"Parts" of taxable articles are also taxable under Section 301. A part so taxable is any article relatively complete within itself and designed or manufactured for the special purpose of being used as a component part of a completed munition, and which, by reason of some peculiar characteristic, loses its identity as a commercial commodity, and which, without further treatment, cannot be used for any purpose other than that for which it was designed.

A stock or commercial commodity, purchasable in the general trade or in the open market, if adapted for use in the manufacture of a munition, is not a "part" within the meaning of Section 301, and will be treated as raw material, provided that such commodities ordinarily classed as commercial are "parts" within the meaning of the law if manufactured *specially for* and sold to a manufacturer to be by him incorporated in and made an essential part of any munitions enumerated in section 301. (Art. 13.)

The opinion has been given by the Commissioner of Internal Revenue that the mere ordering of parts from the manufacturer for use in making munitions does not constitute those parts so ordered taxable, unless they are ordered specifically for and manufactured pursuant to certain specifications given by the munitions manufacturer.

Repairs not taxable.—Manufacturers who make repairs on munitions either for the United States Government or as regular commercial work will not be subject to the munitions tax, provided the repairs are bona fide repairs and do not involve the manufacture and sale of a completed part of a munition. Expense in such repairs for labor, material, etc., must be eliminated as a deduction in the return, since the profit is not considered income for the purpose of the tax.

Explosives.—Gunpowder and other explosives are taxable, excepting blasting powder and dynamite used for industrial (not commercial or sporting) purposes.

Cartridges.—Cartridges, loaded and unloaded, caps or primers, are included, except those used for industrial (not commercial or sporting) purposes.

Projectiles.—Projectiles include any and all missiles to be projected from a gun, cannon, mortar or other firearm, and will include bullets, balls, shot and other missiles. (Art. 2.) All projectiles are taxable.

Shells or torpedoes.—Shells or torpedoes include any receptacle and charge combined. (Art. 2.) All are taxable.

Firearms.—Firearms of any kind and appendages, including small arms, cannon, machine guns, rifles, and bayonets, are included, with no exceptions whatever.

Appendages.—Appendages include those adjuncts or accessories appended to firearms not a part of them, but which facilitate their use, such as straps, belts, scabbards, shields, holsters or other appurtenances common to such firearms. (Art. 2.)

Profits derived from original manufacture and sale of "appendages" are, of course, taxable.

If a manufacturer purchases such appendages and sells them in connection with a firearm which he himself manufactures, as a complete unit, e. g., pistol and holster, the entire profit he makes is taxable. If, how-

ever, he sells the purchased appendage as a separate unit, not in connection with any firearm, he is considered a dealer, and the profit he may make on the sale of the appendage is not taxable.

The cost of purchased appendages or other equipment sold with the completed munition is a proper deduction in ascertaining net profits.

Appendages only partially manufactured will be considered as raw material to the manufacturer who purchases them; the cost is deductible and the profits made upon completion and sale, either with a firearm or separately from it, are taxable.

Electric motor boats.—Electric motor boats are those boats, regardless of size or character of construction, which are propelled by electric power. All such boats are included under the munitions tax, no matter for what purpose they may be used.

Submarines.—Submarine or submersible vessels include all craft, no matter how propelled, manufactured for the purpose of being at will submerged beneath the surface of the water. All are taxable.

Motors and generators manufactured specifically for application in submarines are "parts" within the meaning of the law, and the profits derived by the manufacturer upon their sale and disposition are taxable.

Motors and generators which are not constructed by the manufacturer specifically for and according to specifications furnished by the submarine builder, but are merely sold by him from stock upon receipt of an order from the builder, do not come within the definition of munitions "parts," and the manufacturer in such a case is not liable to the munitions tax.

Aeroplanes are not "munitions."—Although aeroplanes have become identified with the machinery by means of which war is conducted, almost to the exclusion of any other purpose, they are not included as munitions under the law, and are therefore not taxable, since

the tax applies only to profits resulting from the manufacture and sale of the articles specifically mentioned.

Ascertainment of net or taxable income.—As has been made clear in the foregoing pages, the tax attaches only to net income derived from the manufacture and sale of the articles classed as munitions and enumerated and described hereinbefore. In order to ascertain the income which is so taxable, it is necessary to find the gross income received or accrued from the manufacture and sale of munitions, and to subtract from the amount of this gross income the various amounts which are allowed as deductions. The remainder will be the net taxable income. First we must see what is comprised in the term "gross income" for the purposes of the Munitions Tax Law.

Gross income defined.—The gross income contemplated by Title III, and to be reported in the return for the purpose of the munitions tax, is the gross amount received by, or accrued to a taxable person during the calendar year, from the sale or disposition of articles named in section 301, Title III, of the Act of September 8, 1916, with the exemptions previously noted (explosives, etc., used for industrial purposes and contracts performed prior to January 1, 1916).

It must be noted with regard to the paragraph in Art. 10, Reg. 39, which reads as follows: "If, however, the contracts were not fully performed prior to January 1, 1916, any profits resulting from that part of the contracts performed subsequent to January 1, 1916, must be returned for the purpose of this tax," that while this seems to imply that only receipts from the parts of such contracts fulfilled subsequent to January 1, 1916, are taxable, and that deferred payments received for such portions of such contracts as had been completed prior to January 1, 1916, are exempt, such an interpretation is not intended, and it is now held that any and all receipts resulting from such

partly completed contracts, if received after January 1, 1916, are taxable. The paragraph in question wrongly interpreted the clause of section 301, which clause provides for the exemption of payments received only from contracts which the manufacturer had fulfilled *in toto*, for his part, but for which he had not yet received the money which was due him.

"In so far as the paragraph in Article II, Regulations 39, implies that any profits which accrued in deliveries made in 1915 under contracts not fully performed prior to January 1, 1916, and which profits were received subsequent to that date, should not be returned as taxable income when received, it is erroneous, and is hereby annulled.

"The tax being imposed upon net profits received or accrued, the revised ruling as hereinbefore set out, contemplates that all net profits received subsequent to January 1, 1916, on contracts not then fully performed must be returned as taxable profits of the year in which received, regardless of when they may have been earned or accrued.

"Hence net profits received subsequent to January 1, 1916, on deliveries made under contracts which were but partially performed at that date, constitute taxable income of the year in which received, and cannot lawfully be excluded therefrom." (T. D. 2458.)

In this connection also it must be remembered that sales the receipts from which are to be counted as gross income must have been made at a fair market price; that is, the articles must not have been sold at less than the market price for the benefit of an individual or for any other purpose. In case a sale has been so made at less than a fair market price the amount of the proceeds of such sale for the purpose of the tax will be considered as being the amount that would have been received if the articles had been sold at a fair market price.

Deductions allowed from gross income.—In order to ascertain the net income, from the gross income as above defined the following deductions will be made: (a) cost of raw materials; (b) running or general expenses; (c) part cost of new buildings, machinery and equipment; (d) interest; (e) taxes; (f) losses; (g) depreciation; (h) amortization. These will be defined in the following paragraphs, it being borne in mind that each is to be thought of as included under the title of this paragraph—deductions allowed from gross income.

Cost of raw materials.—It will be remembered that munitions under section 301 are (a) completed articles and (b) parts, which have been defined hereinbefore. Raw materials, used in the manufacture of parts, are held to be any crude or elemental products or substances necessary to the manufacture of such parts, and which, without the application of skill or science cannot become component parts or elements in the finished article or unit. As applied to the manufacture of a completed munition, raw materials will include not only such crude products and elemental substances, but all essential finished or unfinished parts as well. The cost of raw material authorized as a deduction, is the cost of raw materials as here defined, which materials are actually used in the manufacture of munitions. Care must be taken to exclude from deduction for cost of raw materials the cost of such raw materials as are used, for example, in another department of the business, which is not devoted to the making of munitions. In other words, the only deduction to be made from gross income on account of the cost of raw materials is the cost of such materials as are actually used in the manufacture of the articles, the profit on the sale or disposition of which is subject to the munition manufacturer's tax.

It is not permitted to charge an increase over the actual manufacturing or purchase cost of raw materials

because of the fact that at some time during the process of manufacture the market price of such material was such that it could have been disposed of at a profit. The Department holds that the fact that the manufacturer in such a case preferred not to sell the raw materials, but to continue the process of manufacturing it into a completed munition, in the hope of receiving the equivalent of such increased price in the ultimate selling price of his product, is evidence that his profit, which he then neglected to take, is reflected in the selling price of the completed munition, and that no deduction, therefore, is allowable except for actual cost, whether of manufacture or of purchase.

The foregoing paragraph is of particular interest to concerns operating several plants, as fixing the basis of price at which the munitions plant shall purchase raw material from another plant operated by the same concern. The raw material must be sold or transferred at actual cost.

Running or general expenses.—Running or general expenses are deductible, to the extent that such expenses are incurred and paid during the year in the manufacture of articles the profits from the sale of which are included in the gross amount of income returned.

Such expenses will include expenditures for rent, repairs and maintenance, heat, light, power, insurance, management, salaries and wages, as well as commissions and bonuses paid for the securing of contracts.

Where another business is carried on in connection with the manufacture of munitions, and the expenses of munition manufacture cannot be segregated from the expenses of the other branches of the business, the expenses deductible are "such a portion of the entire expenses as the gross income received or accrued from the manufacture and sale or disposition of war munitions or parts thereof, is a portion of the entire gross income received or accrued from such entire manufac-

turing business." For example, entire expense is $600,000; gross income from munitions is $300,000; entire gross income is $900,000. In such a case the deductible expense would be one third of $600,000. This is held by the Department to be a more accurate method of apportionment of expense than if "net profits" were taken as a basis.

Since income received, as explained above, from contracts completed prior to January 1, 1916, is exempt, no allowance is permitted to be made for expenses incident to such contracts.

Commissions and bonuses paid for securing munitions contracts are an allowable deduction under "expenses" in case they have been paid for securing contracts the receipts from which are subject to the tax. Such commissions and bonuses, however, should be spread over the life of the contract in a pro rata proportion and deducted from the gross income of each year until the contracts are fully performed.

Cost of buildings, machinery and equipment.—The cost of new buildings, machinery and equipment installed for the manufacture of munitions will be charged to capital account to be taken care of through the depreciation or amortization accounts, which are explained hereafter.

Interest.—The amount deductible from gross income on account of interest is the amount of interest actually paid during the year on debts or loans contracted to meet the needs of the business of manufacturing munitions, and the proceeds of which were actually used for that purpose. This deduction must not include any interest paid on debts or loans the proceeds of which were used to meet the needs of any other business in which the manufacturer may have been engaged. This deduction can be taken only from the gross income of the year in which the interest was actually paid.

As to interest paid in advance, that is prior to 1916, such interest is not deductible if the money upon which the interest paid was used in the furtherance of contracts; but in the event that the money was used in the construction of buildings or purchase of equipment, the interest paid in advance for the use of such money may be added to the cost of buildings and equipment. In such a case the interest is as essentially a part of the cost of the buildings as is the principal so applied, and the entire amount, principal and interest, is subject to the depreciation and amortization charges explained hereafter.

Taxes.—The taxes deductible are those taxes of all kinds which were actually paid during the year in which the gross income was received or accrued and which were imposed with respect to the property used in the manufacture of munitions.

In cases where other businesses are conducted in connection with the making of munitions and the taxes cannot be segregated, the apportionment is made in the same manner as is that of running expenses under similar circumstances, as described hereinbefore.

The War Excess Profits tax is not deductible in ascertaining net munition income for the purpose of measuring the munitions tax. The Treasury Department ruling on this point is as follows:

> The Munition Manufacturer's tax, Title III, section 301, of the Act of September 8, 1916, is an excise tax and not an income tax. It is measured by the net income ascertained as provided by section 302, Title III, Act of September 8, 1916. Paragraph (d) of said section 302 provides for deduction from
>
> "Gross income received or accrued from the sale or disposition" of the product of munitions business
>
> "(d) taxes of all kinds paid during the taxable year with respect to the business or property relating to the manufacture."
>
> The net income by which the War Excess Profits tax is to be measured is the net income determined for income tax purposes, but without the deduction of income or excess profits tax paid within the year. The tax upon this income is in addition to and has no taxable relation to any other tax.
>
> The net income subject to income tax is the difference between gross

income as defined by the Income Tax law and the several deductions provided by that Act. The deductions provided must not include "income or excess profits tax." Section 29, Act of September 8, 1916, as amended by the Act of October 3, 1917, permits this net income, for the purpose of assessment of income tax, to be reduced by the amount of war excess profits tax assessed for the same calendar or fiscal year.

To be deductible for the purpose of munitions tax, a tax must have been paid within the taxable year "with respect to," that is, concerning or because of the business of munitions manufacture, or to have been paid on "property relating to the manufacture," that is, a tax on property having a special reference to the manufacture of munitions.

The War Excess Profits tax is not levied in respect of any business or on any property used in or relating to manufacture, but (in the language of section 201, Act of October 3, 1917) is "in addition to the taxes under existing law and under this Act." It is therefore not deductible under paragraph (d), section 302, Title III, Act of September 8, 1916, in ascertaining net income from munitions manufacture for the purpose of measuring the excise charge on the business of munitions manufacture.

With regard to the capital stock tax and its relation to the munitions tax, the Act provides that the Capital Stock Tax returns shall be made in July and Munitions Tax returns on or before March 1, upon which basis the tax is paid. It therefore follows that if the munitions tax is paid prior to the time the Capital Stock Tax return is prepared and filed in July, the amount of the munitions tax paid in 1917 can be used as a credit against the capital stock tax to be paid for the fiscal year ending June 30, 1918.

As to whether the munitions tax paid when in excess of the capital stock tax paid can be used as a credit in subsequent capital stock tax returns is a question that has not yet been passed on by the Department, but which will be, in case it becomes pertinent to a return.

Losses.—The losses deductible are those actually sustained and charged off during the year for which the return is made, and which were sustained on account of, or in connection with, the business of the manufacture and sale or disposition of munitions or parts thereof, and will include losses from fire, flood, storm, accident or other casualty not compensated by insur-

ance or otherwise. The casualty losses allowable are those only which relate to the business of munitions manufacturing.

Losses sustained in connection with collateral investments or in connection with any other business, the profits from which are not taxable, cannot be deducted from the gross income as contemplated by the Act.

A manufacturer engaged in the business of making munitions, and also of supplying raw materials to other munition manufacturers, may not deduct losses incurred in the latter unless such materials are classed as munitions under the definitions set forth hereinbefore, and as such are taxable.

Depreciation.—Depreciation is a lowering in value or worth, due to age, use or other causes. The deduction authorized on account of depreciation relates to the loss due to use, wear and tear of physical property, owned and used by a manufacturer, but which is not specifically designed or installed for the purpose of manufacturing munitions or parts thereof, and which, without material alteration and change, may be used in connection with any other business in which the person is or may be thereafter engaged.

The annual deduction on this account will be a reasonable allowance determined upon the basis of the cost and probable number of years constituting the life of the property.

Where the same building, machinery or other property is used also for other purposes than the manufacture of munitions, the amount deductible from gross income on account of depreciation will be apportioned in accordance with the rule for apportionment of running expenses, as set forth hereinbefore.

Amortization.—A special amortization deduction is allowable in the case of buildings and machinery constituting plants constructed especially for the manufacture of munitions, and which will have no substantial

value to the manufacturer, except for salvage, when the contracts executed or to be executed for the manufacture of munitions have been fully performed. This allowance is to be determined either (1) by estimating the number of years the property is to be used in the manufacture of munitions, and dividing the cost of the property, less estimated salvage value, by this number; the quotient thus obtained will be the amount of the allowed annual deduction until the cost of the property has been extinguished; or (2) the amortization allowance may be determined on a basis of the quantity of munitions manufactured under contracts in connection with the fulfillment of which the buildings, machinery, or equipment were specially constructed or installed.

The amortization deduction should be set up on the books as soon as possible, but since in practically all cases, the Department holds, it cannot be definitely determined until the end of the year, when the net profits have been determined, it will be permissible, in order to get credit in the return, to set up the amortization charge as soon as it is ascertained, in any event not later than as of December 31st of the year for which the return is made.

Amortization is to be distinguished from depreciation, which is explained in the preceding section. The amounts of all the foregoing allowable deductions, then, when subtracted from the amount of the gross income, leave as a remainder the amount of net income, or profits upon which the tax is payable, at the rate of 12½ per cent for the calendar year 1916 and of 10 per cent for the calendar year 1917. Instructions for making the return are to be found in the following sections:

Return, assessment and payment of tax.—Every person liable for the tax is required to make a return of annual net profits or income in the manner and form prescribed in Form 1089.

This return, properly subscribed and sworn to before an officer qualified to administer an oath, and stamped with the seal of such officer, if he is required to have a seal, must be filed with the Collector of Internal Revenue of the District in which such person has his principal office or place of business, on or before March 1st next following the year in which the return is made or in which the net profits were received or accrued.

If the business is carried on by an individual the return must be signed and sworn to by him; if by a partnership, then by two members of the firm; if by a corporation or association, then by two of the principal officers of such organization.

As soon as practicable after the filing of the return, the Commissioner of Internal Revenue will assess the tax and notify the taxable person of the amount of the tax, which must then be paid to the Collector with whom the return was filed, on or before 30 days from the date of such notice.

If return is not made, or is incorrect.—In case no return is made, or if it is desired to verify the information presented in a return which has been made, the Commissioner of Internal Revenue or his agent is authorized to examine the books of the person subject to the tax or whom the Commissioner may believe is subject to the tax, in order that the amount of taxable profits may be determined and the tax assessed and collected.

Penalties.—The penalty for delinquency in tax payment, if return has been made and tax assessed, is 5 per cent of the amount of the tax and interest at the rate of 1 per cent a month from time tax became due until it is paid.

Failure to make return as required subjects the delinquent to a fine of not more than $10,000 or imprisonment not exceeding one year, or both, and to an

assessment of 50 per cent additional tax. It is provided, however, that in case of sickness or absence of persons required to make or verify the return, the collector may upon application grant an extension of not exceeding 30 days from March 1st, also that if the return is not made within the required time, but is afterward filed voluntarily and without notice from the Collector, and it is shown that the failure to file the return within the time was due to a reasonable cause and not to wilful neglect, the 50 per cent addition may not be made to the tax.

CHAPTER XIX

MUNITION MANUFACTURER'S TAX LAW

BEING TITLE III OF "AN ACT TO INCREASE THE REVENUE AND FOR OTHER PURPOSES," APPROVED SEPTEMBER 8, 1916 (PUBLIC NO. 271, 64th CONGRESS). IN EFFECT SEPTEMBER 9, 1916

TITLE III.—MUNITION MANUFACTURER'S TAX.

Definitions.—Sec. 300 [of the general revenue Act of which this Title is a part]. That when used in this title—

The term "person" includes partnerships, corporations, and associations;

The term "taxable year" means the twelve months ending December thirty-first. The first taxable year shall be the twelve months ending December thirty-first, nineteen hundred and sixteen; and

The term "United States" means only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

Articles subject to tax and rate of tax (see pp. 436-439).—Sec. 301. (1) That every person manufacturing (*a*) gun-powder and other explosives, excepting blasting powder and dynamite used for industrial purposes; (*b*) cartridges, loaded and unloaded, caps or primers, exclusive of those used for industrial purposes; (*c*) projectiles, shells, or torpedoes of any kind, including

shrapnel, loaded or unloaded, or fuses, or complete rounds of ammunition; (*d*) firearms of any kind and appendages, including small arms, cannon, machine guns, rifles, and bayonets; (*e*) electric motor boats, submarine or submersible vessels or boats; or (*f*) any part of any of the articles mentioned in (*b*), (*c*), (*d*), or (*e*); shall pay for each taxable year, in addition to the income tax imposed by Title I, an excise tax of twelve and one-half per centum upon the entire net profits actually received or accrued for said year from the sale or disposition of such article manufactured within the United States: Provided, however, That no person shall pay such tax upon net profits received during the year nineteen hundred and sixteen derived from the sale and delivery of the articles enumerated in this section under contracts executed and fully performed by such person prior to January first, nineteen hundred and sixteen.

Termination of tax after war (see page 457, post).—(2) This section shall cease to be of effect at the end of one year after the termination of the present European war, which shall be evidenced by the proclamation of the President of the United States declaring such war to have ended.

Allowable deductions.—Sec. 302. That in computing net profits under the provisions of this title, for the purpose of the tax there shall be allowed as deductions from the gross amount received or accrued for the taxable year from the sale or disposition of such articles manufactured within the United States, the following items:

(*a*) The cost of raw materials entering into the manufacture;

(*b*) Running expenses, including rentals, cost of repairs and maintenance, heat, power, insurance, management, salaries, and wages;

(*c*) Interest paid within the taxable year on debts

or loans contracted to meet the needs of the business, and the proceeds of which have been actually used to meet such needs;

(*d*) Taxes of all kinds paid during the taxable year with respect to the business or property relating to the manufacture;

(*e*) Losses actually sustained within the taxable year in connection with the business of manufacturing such articles, including losses from fire, flood, storm, or other casualty, and not compensated for by insurance or otherwise; and

(*f*) A reasonable allowance according to the conditions peculiar to each concern, for amortization of the values of buildings and machinery, account being taken of the exceptional depreciation of special plants.

Effect of selling articles at less than fair market price.—Sec. 303. If any person manufactures any article specified in section three hundred and one, during any taxable year or part thereof, whether under any agreement, arrangement, or understanding, or otherwise, sells or disposes of any such article at less than the fair market price obtainable therefor, either (*a*) in such manner as directly or indirectly to benefit such person or any person directly or indirectly interested in the business of such person, or (*b*) with intent to cause such benefit, the gross amount received or accrued for such year or part thereof from the sale or disposition of such article shall be taken to be the amount which would have been received or accrued from the sale or disposition of such article if sold at the fair market price.

Making and filing of returns.—Sec. 304. On or before the first day of March, nineteen hundred and seventeen, and the first day of March in each year thereafter, a true and accurate return under oath shall be made by each person manufacturing articles specified in section three hundred and one to the collector of internal revenue for the district in which such person has

his principal office or place of business, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth specifically the gross amount of income received or accrued from the sale or disposition of the articles specified in section three hundred and one, and from the total thereof deducting the aggregate items of allowance authorized in section three hundred and two, and such other particulars as to the gross receipts and items of allowance as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may require.

Payment of tax.—Sec. 305. All such returns shall be transmitted forthwith by the collector to the Commissioner of Internal Revenue, who shall, as soon as practicable, assess the tax found due and notify the person making such return of the amount of tax for which such person is liable, and such person shall pay the tax to the collector on or before thirty days from the date of such notice.

Procedure when no return or incorrect return is filed.—Sec. 306. If the Secretary of the Treasury or the Commissioner of Internal Revenue shall have reason to be dissatisfied with the return as made, or if no return is made, the commissioner is authorized to make an investigation and to determine the amount of net profits and may assess the proper tax accordingly. He shall notify the person making, or who should have made, such return and shall proceed to collect tax in the same manner as provided in this title, unless the person so notified shall file a written request for a hearing with the commissioner within thirty days after the date of such notice; and on such hearing the burden of establishing to the satisfaction of the commissioner that the gross amount received or accrued or the amount of net profits, as determined by the commissioner, is incorrect, shall devolve upon such person.

Temporary owners, agents and others.—Sec. 307. The tax may be assessed on any person for the time being owning or carrying on the business, or on any person acting as agent for that person in carrying on the business, or where a business has ceased, on the person who owned or carried on the business, or acted as agent in carrying on the business immediately before the time at which the business ceased.

Examination of books.—Sec. 308. For the purpose of carrying out the provisions of this title the Commissioner of Internal Revenue is authorized, personally or by his agent, to examine the books, accounts, and records of any person subject to this tax.

Disclosure or inspection of returns prohibited. — Sec. 309. No person employed by the United States shall communicate, or allow to be communicated to any person not legally entitled thereto, any information obtained under provisions of this title, or allow any such person to inspect or have access to any return furnished under the provisions of this title.

Penalties for false returns.—Sec. 310. Whoever violates any of the provisions of this title or the regulations made thereunder, or who knowingly makes false statements in any return, or refuses to give such information as may be called for, is guilty of a misdemeanor, and upon conviction shall, in addition to paying any tax to which he is liable, be fined not more than $10,000, or imprisoned not exceeding one year, or both, in the discretion of the court.

Administrative provisions.—Sec. 311. All administrative, special, and general provisions of law, relating to the assessment and collection of taxes not specifically repealed, are hereby made to apply to this title so far as applicable and not inconsistent with its provisions.

Regulations. — Sec. 312. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall make all necessary regulations for

carrying out the provisions of this title, and may require any person subject to such provisions to furnish him with further information whenever in his judgment the same is necessary to collect the tax provided for here.

TITLE IX.

Invalidity of one clause not to affect other clauses.—Sec. 900. That if any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of said Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered.

Effective on day following passage of Act.—Sec. 902. That unless otherwise herein specially provided this Act shall take effect on the day following its passage, and all provisions of any Act or Acts inconsistent with the provisions of this Act, are hereby repealed.

Approved by the President, September 8, 1916.

AMENDMENT TO MUNITION MANUFACTURER'S TAX LAW.

Contained in Title II of "An Act to Provide Revenue to Defray War Expenses, and for Other Purposes," Approved October 3, 1917.

(Public—No. 50—65th Congress.)

In effect October 4, 1917.

Rate of tax reduced. — Sec. 214 * * * Subdivision (1) of section three hundred and one of such Act of September eight, nineteen hundred and sixteen, is hereby amended so that the rate of tax for the taxable year nineteen hundred and seventeen shall be ten per centum instead of twelve and one-half per centum, as therein provided.

Act ineffective after January 1, 1918.—Subdivision (2) of such section is hereby amended to read as follows:

"(2) This section shall cease to be of effect on and and after January first, nineteen hundred and eighteen."

Approved by the President, October 3, 1917.

CHAPTER XX

SPECIAL TAXES ON OCCUPATIONS

History.—These special taxes on occupations are part of the miscellaneous taxes included in Title IV of "An Act to Increase the Revenue and for Other Purposes," approved on September 8, 1916. They are based largely on the Acts of June 13, 1898, and October 22, 1914.

In general, Title IV repeals the Emergency Revenue Act of October 22, 1914, except the sections relating to certain occupations and to tobacco manufacturers. The enforcement of these sections was extended to January 1, 1917. Accordingly, the tax on the old basis remained in force for the period up to and including December 31, 1916.

The present tax, which is an annual one, became effective on the first of January, 1917. Inasmuch as the taxable year extends from July first to June thirtieth of the year following, the first assessment was made to include the first six months of 1917. Thereafter the taxable period is one year, extending from the first of July. Accordingly, the tax payment made on July 1, 1917, gives permission to do business up to July 1, 1918.

Who pays the tax.—Every person, firm or corporation doing business in the United States and engaged in any of the nine "occupations" listed below is subject to this tax:

(1) Brokers—executing purchases and sales of stocks and bonds, money, commercial paper, etc.

(2) Pawnbrokers.

(3) Ship brokers.

(4) Custom-house brokers.
(5) Proprietors of theaters, museums and concert halls.
(6) Proprietors of circuses.
(7) Proprietors or agents of all other public exhibitions or shows.
(8) Proprietors of bowling alleys and billiard rooms.
(9) Tobacco manufacturers.

Brokers.—The annual tax payable by brokers is $30. For the purpose of this tax a broker is considered to be any person, partnership or corporation whose business it is to execute for others purchases or sales of stocks, bonds, exchange, bullion, coined money, bank notes, promissory notes or other securities.

In determining liability for this tax it is important to find out whether or not orders are being executed for others. There is no liability where a person negotiates purchases or sales solely for himself. According to the terms of a court decision: "It is only when making sales and purchases is his business, his trade, his profession, his means of getting his living or making his fortune, that he becomes a broker within the meaning of the statute." (Warren v. Shook, 91 U. S., 704.)

The following cases, chosen from the Treasury decisions based upon the provisions of the old law, illustrate the general scope of this section of the present law. Inasmuch as this "special tax on occupations" is practically identical with the War Revenue Acts of June 13, 1898, and Oct. 22, 1914, it is assumed that Treasury Department rulings relating to the latter Act will apply in the administration of this Act.

Loan and mortgage companies are not liable for loaning money on notes or bonds secured by a mortgage or trust deed on real estate. However, if they purchase notes, bonds or other securities they become liable as brokers.

A mining syndicate or other association issuing certificates of stock in a company organized by it is not required to pay a special tax as a broker as a result of those transactions. However, a manager or other person employed to sell the certificates on commission is a broker and is required to pay the tax.

Express companies engaged in the business of buying or selling foreign money or bills of exchange are subject to the tax. On the other hand, an express or railway agent doing business for his principals only is not considered a broker and therefore is not taxable.

The business of selling land on commission, taking applications for farm loans and writing insurance is not the business of a broker and therefore the tax is not imposed.

Each branch office of a broker is subject to the tax. For the purpose of this tax a branch office is considered to be one where the employee in charge not only receives and transmits orders with the money to the main office, but also receives from the main office moneys for disbursement to customers, or keeps accounts with customers, or does other business with relation to the transactions of brokers at such branch offices.

A case in point to illustrate the application of this regulation will serve to make the ruling clear: A corporation, a dealer in investment securities, selling securities that it owns itself, has branch offices under the control of managers, who in turn employ a number of agents as salesmen. Both the managers and the salesmen are employed under a contract that requires them to devote their whole time to the sale of the securities of the house in question. Class A of these branch offices both purchases and sells securities under authority of the main office. Class B of the offices confines itself to the sale of securities. Are either or both of these classes subject to the brokers' tax? In this in-

stance the Treasury Department decided that all branch offices in both classes A and B were subject to the tax.

Pawnbrokers.—The annual tax payable by pawnbrokers is $50. According to the provisions of this Act, the pawnbroker's business is one which receives, by way of pledge, pawn or exchange, any goods, wares, merchandise or any kind of personal property as security for the repayment of money loaned.

Although up to this time there have been but few Treasury decisions on special phases of this new law, there are available those applying to the old law which is similar in almost every respect. It is safe to assume, therefore, that the former rulings will apply with equal force to this law. The following are of importance:

A person is not required to pay a special tax as a pawnbroker for rare or occasional acts which cannot be regarded as his business or occupation.

The tax is not required to be paid for making loans when the chattels are not taken or received by way of pledge, pawn or exchange.

A person using no tickets in his business, but making a pretense of buying articles which are brought to him, which he holds with a verbal agreement, that the articles can be bought back again by the person selling them upon the payment of a specified bonus, is liable to the tax as a pawnbroker.

Ship brokers.—The amount of annual tax payable by ship brokers is $20. Under this classification is included every person, partnership or corporation whose business it is as a broker to negotiate freights and other business for the owners of vessels, or for the shippers or consignors or the consignees of freight carried by vessels. These provisions of the law are specific and require no further discussion.

Custom-house brokers.—For custom-house brokers the annual tax is $10. Agents for others, whose business it is to arrange entries and other custom-house papers, or transact at any port of entry, business relating to imports and exports of goods, wares or merchandise, are considered to be custom-house brokers.

If the complete business of a custom-house broker is transacted by or through offices at different ports in one district, a separate and distinct tax of $10 must be paid for each of the offices.

A tax stamp taken out by a person in his own name as a custom-house broker is sufficient to cover the business done by him in his own name, at the place of business stated therein, whether the business is done by him on his own account or as an agent for other persons.

An agent for others, whose business it is to enter and clear vessels at the custom-house, cannot be relieved from payment of the tax on custom-house brokers, even though he may in addition have paid a tax as ship broker.

Proprietors of theaters, museums and concert halls.—The annual tax payable by proprietors of theaters, museums and concert halls is graded according to the following scale, based upon the seating capacity:

A seating capacity of not more than 250..	$25
A seating capacity of more than 250 and not over 500	50
A seating capacity of more than 500 and not over 800	75
A seating capacity of more than 800......	100

In cities, towns or villages having a population of 5,000 or less, the amount of tax payable by proprietors will be in each case one-half of the amount indicated in the above summary.

Every edifice used for the purpose of dramatic, operatic or other performances for which a charge for ad-

mission is made is subject to the tax. Armories or halls used only occasionally for concerts or theatrical performances are not required to pay the tax.

Moving picture shows are taxable as theaters on the same basis as that above mentioned.

Airdomes in which are given open-air operatic or dramatic or other representations, plays or moving picture shows, are taxable according to the seating capacity, as are theaters, museums, etc. An exception is made, however, in those cases where the airdome is operated in conjunction with a theater for which the tax has been paid. Provided the seating capacity of the airdome does not exceed that of the theater, and that performances are not given simultaneously in the airdome and in the theater, only one tax is payable. The tax paid for the theater will be considered to cover also the performances given in the airdome.

Where the proprietor of a theater operates an airdome at another location, he may, upon closing his theater, transfer to the airdome the tax stamp originally issued for the theater. It is understood, of course, that in such a case the seating capacity of the airdome may not exceed that of the theater. Similarly, the tax stamp may be transferred from an airdome to a theater operated by the same proprietor.

In cases where the tax is paid for a theater of a certain capacity and subsequently its capacity is increased, the tax is payable at the highest rate. However, redemption of the former tax stamp may be made for its unexpired term.

The owners or agents of theatrical troupes, traveling around the country and giving performances in halls or auditoriums for which the tax has not been paid by the owners or lessees, are required to pay the *special tax* on occupations. They may have the tax stamps transferred from place to place, within the State only, upon application to the Collector of Internal Revenue.

Proprietors of circuses.—The annual tax payable by proprietors of circuses is $100. This tax is payable in every State or Territory or in the District of Columbia, in which an exhibition is given. When a circus is exhibiting in any State, say in the month of July, the special tax of $100 is required to be paid for the year beginning July first. If in the following month the circus goes into another State, the tax at the rate of $100 for the year is to be reckoned from the first of August to the first of July following, and a separate tax stamp must be taken out for that State, and so on.

For each additional attraction, side show and the like, for which a separate charge for admission is made, there is a special tax liability at the rate of $10 per annum. This tax is payable according to the terms of that section of the Act taxing "proprietors or agents of all other public exhibitions or shows."

For the purposes of this Act, a circus is understood to be an exhibition of "feats of horsemanship, or acrobatic sports or theatrical performances not otherwise provided for" in the other eight classes of "occupations" mentioned in the Act.

Variety shows, whether given at summer resorts or elsewhere, which include "acrobatic sports," come within the definition of a circus. They are taxable accordingly.

In some cases there is a fine distinction between exhibitions classified as circuses, taxable at the rate of $100 per annum, and those coming under the classification of "other public exhibitions or shows," taxable at the rate of $10 per annum. The Treasury Department has given a ruling to the effect that "a show under canvas exhibiting, among other things, acrobatic and athletic exercises, but not feats of horsemanship and having no menagerie, is not subject to special tax as a circus—if the acrobatic exercises are so few and simple as to make it unreasonable to hold that they constitute the show a circus." It is a show coming under the cap-

tion of "all other public exhibitions or shows," considered in the following section of this chapter.

Proprietors or agents of all other public exhibitions or shows.—The amount of annual tax payable for exhibitions coming under this classification is $10. All forms of exhibitions, etc., not specially provided for in the preceding sections of the Act are taxable under the provisions of this paragraph. An exception is made of "Chautauquas, lecture lyceums, agricultural or industrial fairs, or exhibitions held under the auspices of religious or charitable associations." These are not taxable. As with other forms of exhibitions and shows, the tax is payable for each State in which the performance or show is given.

In a case brought before the District Court of the United States by the Redpath Lyceum Bureau, the claim of tax exemption was made. The Act provides that the tax shall not apply to "Chautauquas, lecture lyceums, agricultural or industrial fairs or exhibitions under the auspices of religious or charitable associations." It was on the strength of this provision that the Redpath Company claimed tax exemption.

The decision of the court was to the effect that the company was not a lecture lyceum within the meaning of the Act, that the entertainments were not given under the auspices of churches and that consequently the company would be required to pay the tax.

For wagon shows, dog and pony shows, and other similar exhibitions that do not come under the heading of circuses, the annual tax of $10 is payable.

Traveling carnival companies, if charging one general admission to the grounds, are required to pay the tax at the rate of $10 per annum. Also, for each separate attraction for which a separate admission is charged, an additional tax at the rate of $10 per annum is required to be paid.

The show of a medicine vender is taxable under this

section of the Act at the rate of $10 per annum. Such a show will generally include athletic, humorous and comic performances, and also an exhibition of rope-walking and trapeze performances, the object of which is to attract a crowd.

Agricultural associations are required to pay a special tax at the rate of $10 for exhibitions which include horse racing.

Exhibitions and shows given on fair grounds, but not under management of the fair association, are taxable.

Concert gardens where no admission fee is charged, but where beer and other drinks are sold, and shows or stage entertainments are given, come under this classification and are taxable accordingly.

A lecturer using a stereopticon to illustrate his lecture, and charging an admission fee, is liable to the special tax.

Exemptions.—The following are examples of shows and entertainments not taxable, according to former Treasury Department rulings:

The tax is not required to be paid by proprietors of restaurants or cafés for employing bands of music or orchestras during meal hours for the benefit of their patrons. The provision is made, however, that there shall be no admission charge and that no performance or exhibition shall be given in connection therewith.

Amateur theatrical exhibitions, given either in private houses or in licensed public halls, for payment of expenses incurred in giving the show and not for pecuniary profit, are not subject to the tax.

Amateur clubs or local organizations giving exhibitions, even though they charge an admission price, are not required to pay the tax if the proceeds are not for the pecuniary profit of the clubs or associations but are devoted to some charitable object and the payment of expenses.

The tax is not required for bands of music playing

in saloons to which no price of admission is charged and where persons visiting such places are not under any obligation to buy.

Other entertainments not taxable are: merry-go-rounds, fortune telling, football, baseball, etc., bands in city parks, university exhibitions, and the like.

Proprietors of bowling alleys and billiard rooms.—Every building or place where bowls are thrown or where games of billiards or pool are played, except private houses, is regarded as a bowling alley or a billiard room. The tax is $5 per annum for each alley or table.

A recent opinion of the Treasury Department is to the effect that the tax is applicable to pool or billiard tables and bowling alleys in clubs, fraternity houses, lodge halls, charitable institutions, Y. M. C. A. buildings, hotels, boarding-houses, etc. These are not considered as coming under the classification of "private homes," and consequently are taxable.

Concerning pool tables, etc., maintained for the use of officers and employees of State and municipal governments, a fine point of distinction arises. In the event of the tax falling upon the individuals, group of individuals, association or the like, the tax is payable. However, the tax is not applicable if the assessment would have the effect of levying upon the public treasury. The latter is true because of the fact that the Federal Government does not have the right to tax "the sovereign instrumentalities of a State government necessary to the exercise of its governmental functions."

Post exchanges operated under the complete control of the Secretary of the Navy as governmental agencies are not taxable.

Tobacco manufacturers.—Every person, firm or corporation engaged in the manufacture and sale of tobacco is subject to this tax. In all cases the tax is computed on the basis of the annual sales during the preceding fiscal year.

Herewith is summarized the basis of the annual tax, based upon the volume of business transacted during the year preceding:

Manufacturers of tobacco:

Annual sales not exceeding 50,000 pounds	$3
Annual sales over 50,000 pounds but not exceeding 100,000 pounds	6
Annual sales over 100,000 pounds but not exceeding 200,000 pounds	12

Annual sales exceeding 200,000 pounds are taxable at the rate of 8 cents for each 1,000 pounds or fraction thereof.

Manufacturers of cigars:

Annual sales not exceeding 50,000 cigars	2
Annual sales over 50,000 cigars but not exceeding 100,000 cigars	3
Annual sales over 100,000 cigars but not exceeding 200,000 cigars	6
Annual sales over 200,000 cigars but not exceeding 400,000 cigars	12

Annual sales exceeding 400,000 cigars are taxable at the rate of 5 cents for each 1,000 cigars or fraction of 1,000.

Manufacturers of cigarettes:

Annual sales of cigarettes and "little cigars," not weighing more than three pounds per 1,000, are taxable at the rate of 3 cents for each 10,000 cigarettes or fraction of 10,000.

In all cases where a person, firm or corporation manufactures more than one of these classes of articles, the tax is payable on each class on the basis as indicated above, based on annual sales.

Each manufacturer is required to pay tax at the appropriate rate for each factory operated under his exclusive ownership or control.

Where more than one factory or branch is operated

by the same manufacturer, each tax should be paid to the collector of the district where the factory or place of business is located. The tax stamp showing tax payment should be posted at each factory or place of business.

In making a tax return the manufacturer should file a sworn statement covering each factory or branch, showing total sales during the preceding fiscal year. This return should state the factory number, district and State, as to the factory operated, and also the output of the factory.

The amount of the tax is computed in all cases on the basis of sales made during the preceding fiscal year. Total sales made during that period is the basis, regardless of whether business was conducted during the whole year or only part of the year.

Dealers or manufacturers who were not engaged in business during the preceding fiscal year must pay the tax and secure the stamps before commencing business. The amount of the tax will be based on the dealer's or manufacturer's estimate of the probable amount of his business during the year. When the limit of sales allowed by the tax already paid is reached, the law requires that additional tax be paid. At all times the liability to tax on the basis of sales should be covered.

Below is given a synopsis of Treasury Decisions made under the Act of June 13, 1898. Although these may not be considered to be binding under the present Act, they will without doubt be given weight in considering similar questions.

A manufacturer of tobacco or cigars cannot sell at retail at the place of manufacture.

Manufacturers cannot pack goods of another factory with goods made at their own factory.

A farmer or grower of tobacco has the right to sell tobacco of his own growth and raising to any person and in any quantity that may be desired, provided its

condition has not been changed in any manner; this, however, is a personal privilege, and cannot be delegated by him to another person. The farmer cannot employ another person to travel from place to place to sell and deliver tobacco to consumers. He has not the right to place the tobacco in the hands of another person, to be sold for him to consumers. However, he may place it in the hands of a qualified dealer in leaf tobacco, to be sold on commission to other qualified dealers, or to manufacturers of tobacco or cigars, or to persons who buy leaf tobacco in packages for export.

A tax stamp issued to one person cannot be transferred to or made use of by another. The one exception to the rule is in the event of the death of the taxpayer.

Filing of returns.—The annual tax return is required to be filed by every person, firm, company, corporation or association subject to the tax. The return is to be made under oath and filed with the Collector of Internal Revenue of the district in which the business it situated. Payment of the tax in the form of cash, certified check or money order, accompanied by the return, should be made before the month of July of each succeeding year.

Newly organized businesses should file the report and pay the tax before beginning operations.

Penalties.—The law provides that "every person who carries on any business or occupation for which special taxes are imposed by this title, without having paid the special tax therein provided, shall, besides being liable to the payment of such special tax, plus a penalty of 50 per cent, be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not more than $500, or be imprisoned for not more than six months, or both, in the discretion of the court."

Special tax stamps are required to be posted conspicuously at the place of business.

CHAPTER XXI

OCCUPATIONAL TAXES LAW

BEING TITLE IV, OF "AN ACT TO INCREASE THE REVENUE AND FOR OTHER PURPOSES." APPROVED SEPT. 8, 1916 (PUBLIC—No. 271—64th CONGRESS) IN EFFECT SEPTEMBER 9, 1916

TITLE IV.—MISCELLANEOUS TAXES

Tax on brokers.—Sec. 407. That on and after January first, nineteen hundred and seventeen, special taxes shall be, and hereby are, imposed annually, as follows, that is to say:

First. [The first subdivision related to bankers, and went out of effect January 1, 1917.]

Second. Brokers shall pay $30. Every person, firm, or company whose business it is to negotiate purchaes or sales of stocks, bonds, exchange, bullion, coined money, bank notes, promissory notes, or other securities, for others, shall be regarded as a broker.

Tax on Pawnbrokers.—Third. Pawnbrokers shall pay $50. Every person, firm, or company whose business or occupation it is to take or receive, by way of pledge, pawn, or exchange, any goods, wares, or merchandise, or any kind of personal property whatever, as security for the repayment of money loaned thereon, shall be deemed a pawnbroker.

Tax on ship brokers.—Fourth. Ship brokers shall pay $20. Every person, firm, or company whose business it

is as a broker to negotiate freights and other business for the owners of vessels, or for the shippers or consignors or consignees of freight carried by vessels, shall be regarded as a ship broker under this section.

Tax on customhouse brokers. — Fifth. Customhouse brokers shall pay $10. Every person, firm, or company whose occupation it is, as the agent of others, to arrange entries and other customhouse papers, or transact business at any port of entry relating to the importation or exportation of goods, wares, or merchandise, shall be regarded as a customhouse broker.

Tax on proprietors of theaters, etc.—Sixth. Proprietors of theaters, museums, and concert halls, where a charge for admission is made, having a seating capacity of not more than two hundred and fifty, shall pay $25; having a seating capacity of more than two hundred and fifty and not exceeding five hundred, shall pay $50; having a seating capacity exceeding five hundred and not exceeding eight hundred, shall pay $75; having a seating capacity of more than eight hundred, shall pay $100. Every edifice used for the purpose of dramatic or operatic or other representations, plays, or performances, for admission to which entrance money is received, not including halls or armories rented or used occasionally for concerts or theatrical representations, shall be regarded as a theater: Provided, That in cities, towns, or villages of five thousand inhabitants or less the amount of such payment shall be one-half of that above stated. Provided further, That whenever any such edifice is under lease at the passage of this Act, the tax shall be paid by the lessee, unless otherwise stipulated between the parties to said lease.

Tax on proprietors of circuses.—Seventh. The proprietor or proprietors of circuses shall pay $100. Every building, space, tent, or area where feats of horsemanship or acrobatic sports or theatrical performances not otherwise provided for in this section are exhibited shall

be regarded as a circus: Provided, That no special tax paid in one State, Territory, or the District of Columbia shall exempt exhibitions from the tax in another State, Territory, or the District of Columbia, and but one special tax shall be imposed for exhibitions within any one State, Territory, or District.

Tax on proprietors of other shows for money.—Eighth. Proprietors or agents of all other public exhibitions or shows for money not enumerated in this section shall pay $10: Provided, That a special tax paid in one State, Territory, or the District of Columbia shall not exempt exhibitions from the tax in another State, Territory, or the District of Columbia, and but one special tax shall be required for exhibitions within any one State, Territory, or the District of Columbia: Provided further, That this paragraph shall not apply to Chautauquas, lecture lyceums, agricultural or industrial fairs, or exhibitions held under the auspices of religious or charitable associations: Provided further, That an aggregation of entertainments, known as a street fair, shall not pay a larger tax than $100 in any State, Territory, or in the District of Columbia.

Tax on proprietors of bowling alleys and billiard rooms.—Ninth. Proprietors of bowling alleys and billiard rooms shall pay $5 for each alley or table. Every building or place where bowls are thrown or where games of billiards or pool are played except in private homes shall be regarded as a bowling alley or a billiard room, respectively.

Taxes on tobacco manufacturers.—Sec. 408. That on and after January first, nineteen hundred and seventeen, special taxes on tobacco, cigar and cigarette manufacturers shall be, and hereby are, imposed annually as follows, the amount of such annual taxes to be computed in all cases on the basis of the annual sales for the preceding fiscal year:

Manufacturers of tobacco whose annual sales do not exceed fifty thousand pounds shall each pay $3;

Manufacturers of tobacco whose annual sales exceed fifty thousand and do not exceed one hundred thousand pounds shall each pay $6;

Manufacturers of tobacco whose annual sales exceed one hundred thousand and do not exceed two hundred thousand pounds shall each pay $12;

Manufacturers of tobacco whose annual sales exceed two hundred thousand pounds shall each pay at the rate of 8 cents per thousand pounds, or fraction thereof;

Manufacturers of cigars whose annual sales do not exceed fifty thousand cigars shall each pay $2;

Manufacturers of cigars whose annual sales exceed fifty thousand and do not exceed one hundred thousand cigars shall each pay $3;

Manufacturers of cigars whose annual sales exceed one hundred thousand and do not exceed two hundred thousand cigars shall each pay $6;

Manufacturers of cigars whose annual sales exceed two hundred thousand and do not exceed four hundred thousand cigars shall each pay $12;

Manufacturers of cigars whose annual sales exceed four hundred thousand cigars shall each pay at the rate of 5 cents per thousand cigars, or fraction thereof;

Manufacturers of cigarettes, including small cigars weighing not more than three pounds per thousand, shall each pay at the rate of 3 cents for every ten thousand cigarettes, or fraction thereof.

In arriving at the amount of special tax, to be paid under this section and in the levy and collection of such tax, each person, firm, or corporation engaged in the manufacture of more than one of the classes of articles specified in this section shall be considered and deemed a manufacturer of each class separately.

Penalties.—Every person who carries on any business or occupation for which special taxes are imposed by

this title, without having paid the special tax therein provided, shall besides being liable to the payment of such special tax, be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not more than $500, or be imprisoned not more than six months, or both, in the discretion of the court.

Administrative provisions.—Sec. 409. That all administrative or special provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this title, and every person, firm, company, corporation, or association liable to any tax imposed by this title, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may from time to time prescribe.

Act of October 22, 1914, repealed in part.—Sec. 410. That the Act approved October twenty-second, nineteen hundred and fourteen, entitled "An Act to increase the internal revenue, and for other purposes," and the joint resolution approved December seventeenth, nineteen hundred and fifteen, entitled "Joint resolution extending the provisions of the Act entitled 'An Act to increase the internal revenue, and for other purposes,' approved October twenty-second, nineteen hundred and fourteen, to December thirty-first, nineteen hundred and sixteen," are hereby repealed, except sections three and four of such Act as so extended, which sections shall remain in force till January first, nineteen hundred and seventeen, and except that the provisions of the said Act shall remain in force for the assessment and collection of all special taxes imposed by sections three and four thereof, or by such sections as extended by said joint resolution, for any year or part thereof ending prior to January first, nineteen hundred and seventeen, and of all other taxes imposed by such Act, or by such Act as

so extended, accrued prior to the taking effect of this title, and for the imposition and collection of all penalties or forfeitures which have accrued or may accrue in relation to any of such taxes.

Approved by the President, September 8, 1916.

CHAPTER XXII

WAR EXCISE TAXES

Excise taxes on sales.—War excise taxes on tobacco products, beverages and certain other commodities are imposed by the Act of October 3, 1917, the date of their passage being construed by the Treasury Department as meaning October 4, 1917, the date upon which the Act became effective. Such taxes as these have been a favorite means of obtaining revenue during the financial stress attendant upon the several war crises in the history of the United States. The articles upon which they have been imposed have been usually what may, in a sense, be termed "luxuries"; that is, not indispensable, in the last analysis, yet for which the public would be willing to pay a price which included the tax rather than forego them. Such taxes were first levied by the Act of March 3, 1791. Prior to the Civil War they were regarded as an emergency measure, but since then excise taxes upon tobacco products and beverages have become a regular part of the taxation system of the country. Naturally, as emergency measures, excise taxes were designed primarily for the purpose of obtaining revenue.

The Act of October 3, 1917, levied heavy additional taxes on manufacturers and importers of tobacco products and beverages, and also extended this method of taxation to a number of articles which may be classed as luxuries. A detailed list of the articles will be found in the text of the law. A summary, with the amount of the tax in each case, is as follows:

Under section 600: motor vehicles, mechanical musical instruments, including records for player pianos and phonographs; jewelry, real or imitation; cameras and process cameras; sporting goods, such as tennis rackets, golf clubs, baseball bats, baseballs, footballs, billiard and pool tables, and balls, but with the exception of children's toys and games: a tax at the time of sale amounting to 3 per cent of the selling price.

Toilet preparations; proprietary or "patent" medicines; chewing gum: 2 per cent of selling price.

Moving picture films, not exposed: one-fourth of 1 cent for each linear foot; exposed, that is, ready for projection or exhibition: one-half of 1 cent per linear foot. These taxes are imposed when the film is first sold or leased, and are payable, like other excise taxes, only once.

Under section 603: yachts and boats of the kinds enumerated below, with the exception of those used exclusively in trade or in national defence, and also with the exception of those built according to plans and specifications approved by the Navy Department:

Yachts; pleasure boats; power boats; motor boats with fixed engines and sailing boats of over five tons: length not over fifty feet, fifty cents for each foot; length over fifty feet and not over one hundred feet, $1 for each foot; length over one hundred feet, $2 for each foot; motor boats of not over five net tons, with fixed engines, $5. The length which is to govern in determining the measurements is "over-all" length.

Floor taxes.—Upon the foregoing, with the exception of moving-picture films and boats, a floor tax is imposed, designed to tax the stocks of these commodities in the hands of wholesalers or jobbers at the time of the passage of the Act. This floor tax is an amount equivalent to one-half the amount of the tax upon the sale of the respective classes of articles, that is, one-half of 3 per cent upon the one class and one-half of 2 per cent

upon the other, based on the price paid for the articles by the wholesaler or jobber when he purchased them. Those liable to this floor tax are any person or corporation other than (1) a retailer who is not also a wholesaler or (2) the manufacturer, producer or importer.

A retailer who is not also a wholesaler is defined as being one who does not make it a substantial part of his business to sell to other dealers, and who does not seek or solicit such business for profit, although he may occasionally sell goods to other retailers at less than the retail price. Dealers in automobiles who sell both to users and sub-agents for resale are wholesalers and liable to floor tax.

Section 602, which imposes this floor tax, provides that "nothing in this section shall be construed to impose a tax upon articles sold and delivered prior to May 9, 1917, where the title is reserved in the vendor as security for the payment of the purchase money."

Shipments in transit on October 4, 1917, charged to a jobber's account, but shipped direct to the retailer, are not subject to the floor tax, if invoice was mailed to the consignee prior to October 4, in which case the goods belonged to the consignee, and not to the jobber.

Goods shipped and invoiced prior to October 4, if shipped to a wholesaler, are liable to the floor tax. If, however, the title is reserved by the manufacturer he is subject to the manufacturer's sales tax and the wholesaler is relieved of the floor tax.

In the case of retail and wholesale stocks kept by the same establishment, the retail stock is not subject to the floor tax, provided that the retail and wholesale departments are kept separate, so far as bookkeeping and stockkeeping are concerned.

The floor tax returns were to be made, as provided in section 1002, within thirty days of the passage of the Act. The date of payment, but not that of the filing of the return, may be extended, by the filing of

a satisfactory bond, to a date not later than seven months from the passage of the Act. For form of bond for the extending of payment of certain taxes, see Form 723, of the Treasury Department.

Liberty bonds or certificates of deposit on purchase of Liberty bonds are acceptable as security for the payment of floor taxes.

Excise tax on sales—by whom paid.—The excise tax on sales is to be paid by the manufacturer, producer or importer, no exception being made in the case of goods exported.

Where a contract made with a dealer, for sale or lease, prior to May 9, 1917, precludes the adding of the whole amount of tax to the contract price, the vendee or lessee must pay the excess to the vendor at the time the sale or lease is consummated, but the actual payment of the tax must be made by the vendor.

The term "dealer" includes a vendee who purchases an article with intent to use it in the manufacture or production of another article intended for sale.

"Manufacturer" is construed to mean the latest manufacturer; that is, the one who completes an article ready for use by the consumer. Bottlers of drugs or other goods received in bulk are held to be manufacturers.

Where a manufacturer consigns his entire product to a retailer, retaining ownership in the same until sold by the retailer, he must make monthly returns, and to do this he must secure returns from the retailer of the goods sold.

Returns—excise tax on sales.—Those subject to the excise tax on sales must make returns monthly in duplicate, on or before the close of the month following that for which the return is made, and pay the tax to the collector of internal revenue for the district in which is located the principal place of business.

They should enter on the return the net quantity of

sales during the month, determined by deducting from the gross quantity of sales during such month, trade discounts and any quantity sold during any previous month on which the tax was paid and which has been returned or for which credit has been allowed for any other reason.

Itinerant manufacturers must report sales and pay the tax in the district in which the sale is made.

The word "sold" is construed to mean that a contract of sale has been entered into between vendor and vendee under the terms of which the article which is the subject of the contract became the property of the vendee.

A transfer by a manufacturing corporation to a selling corporation is a sale, and in such a case the price at which taxable goods shall be sold to the selling corporation must not be less than that charged to independent distributors under similar conditions.

Goods delivered subject to buyer's approval are not to be reported until sale is completed.

Motor vehicles.—No tax under this Act is upon the user or purchaser of motor vehicles but only upon the manufacturer, producer or importer. There are no exemptions for cars or motor trucks used for business purposes; all are taxable.

Motor vehicles manufactured abroad by companies completely controlled or managed in the United States are taxable. There is no drawback on exported automobiles.

Automobiles and motorcycles sold to the United States for the use of the army, including those sold by the manufacturer to the United States Government on contract at contract prices, are taxable.

A chassis is held to be an automobile.

An automobile body is not taxable when sold alone; when sold with a chassis the tax rests upon the completed article. A motor wheel sold alone is not taxable, but when sold in connection with a bicycle,

velocipede or other vehicle, the tax attaches to the completed article. The "Smith-Flyer," for example, a self-propelled vehicle, is taxed as an automobile.

A usable automobile, assembled from new or second-hand parts, is taxable, but used or second-hand automobiles are not taxable.

Motorcycle side cars are not taxable unless sold with the motorcycle, in which case the tax attaches to the completed article.

Where a chassis is sold to a consumer or other person or concern not subject to the tax, the sale is taxable, but if sale is made to one who is subject to tax, the tax will be paid by the manufacturer of the completed machine.

Attachments or accessories are taxable if sold with the machine, otherwise they are not taxable.

Mechanical musical instruments.—The mechanical musical instruments enumerated, together with the records used in connection therewith, are taxable at the 3 per cent rate. It is held that accessories for player pianos, phonographs, etc., other than records, are not taxable unless sold with the instrument, in which case the tax attaches to the price for which the instrument and its accessories is sold.

Player pianos have been held not to be taxable. The tax on piano players applies to the player device if sold as a separate instrument or as a separate feature. Where a player is sold as incorporated in a piano, the tax is upon the price of the player as a separate device, if such price can be separately determined; otherwise, the tax is upon the entire instrument, including piano.[1]

Toy talking machines or phonographs are taxable.

Dictaphones and dictagraphs, used for commercial purposes, are not taxable.

[1] The recent decision (January 2, 1918) holding that player pianos are not taxable except when sold as a unit with player device, the price of which can not be segregated, is expected to save the piano trade $1,000,000 a year.

Moving picture films.—The amount of the tax on moving picture films is given above. The tax is not on the manufacture of the film itself, but only upon its sale or lease, so that no floor tax applies. A distributor of films, pure and simple, is not subject to this tax.

A laboratory doing the mechanical work of producing a positive print, and charging the owner for labor and materials, and having itself no ownership in the films, will not be regarded as the manufacturer and is not liable to the tax if it does not sell or lease the film. Such a laboratory, however, should keep a record of such films for the information of revenue officers. Blank films are taxable only when sold by a manufacturer or importer. Printed or hand-lettered titles or subtitles used in connection with a picture are held to be a part of the film and should be included in the length of the film when tax is computed. If these projections are in the shape of slides or announcements, however, no tax attaches.

Returns are to be made on or before the last day of each month, covering the sales or leases made during the preceding month. For films not exposed the return will show the number of linear feet sold during the month; for films containing a picture ready for projection the returns will show the number of linear feet sold or leased during the month. The rates of tax are $\frac{1}{4}$ and $\frac{1}{2}$ of 1 cent per foot respectively, and are payable only once, when the film is first sold or leased.

Jewelry.—The tax on jewelry, 3 per cent of selling price, is to be computed by manufacturers upon the price they make to wholesalers and retailers, less trade discounts.

As to what is classed as jewelry, all articles so classed by the Board of Custom Appraisers are included.

All precious stones, real or imitation, whether cut

or uncut, which are set and ready to wear in condition sold are classifiable as jewelry and are subject to the tax. Precious stones cut but not set are taxable if sold by the importer, or if cutting is done in the United States, when sold by the manufacturer or dealer for whom the cutting was done. Matched pearls sold to a customer are taxable, but not if sold to dealers for further manufacture or completion. This applies also to loose, drilled pearls.

All watches not used solely for utility purposes are classed as jewelry, also watches worn externally for ornament, and all other watches ornamented with jewels, or other ornamentation than engraving or engine turning.

The following when made of precious or imitation metals to be carried on the person are taxable as jewelry:

Dorean (powder) boxes; vanity boxes; stamp boxes; match boxes; cigarette cases; cigar cases; eyeglass cases; eyeglass chains; eyeglass holders; lorgnettes; lorgnons; card cases; vinaigrettes; handkerchief holders; garters; suspenders; emblem charms; emblem pins; emblem buttons; mesh bags; memorandum books; lip salve cases; eyebrow pencils; cigar cutters; compasses; key chains; key rings and other like articles.

Other articles specifically classed as jewelry are: (*a*) a string of rose beads, (*b*) pencil- and penholders manufactured of precious or imitation precious metals, (*c*) souvenir pins for use and sold at summer resorts, (*d*) knitting needles, protectors, yarn holders, etc., if mounted or decorated in any way with precious or imitation precious metals, (*e*) slides and swivels used in connection with a ribbon chain, (*f*) lapel flag pins.

It is held that the following shall not be considered as jewelry: (*a*) silver tableware, (*b*) eyeglass frames, (*c*) plain opera and field glasses, (*d*) clocks, (*e*) fountain pens, (*f*) rosaries, (*g*) American Red Cross but-

tons, (*h*) metal bag frames for attachment to silk bags, (*i*) repairs on jewelry, (*j*) military and naval insignia, (*k*) plain hair combs made of rubber, shell, or celluloid, absolutely unadorned.

Sporting goods, etc.—The tax of 3 per cent is imposed only upon such sporting goods as are specifically mentioned in the Act.

Bamboo fishing poles, skee ball and box-ball alleys, flinch and rook cards, or any other games played by both adults and children are taxable.

Wooden racks used as receptacles for poker chips and playing cards, toy tennis rackets, tackle and other fishing rod appurtenances, are not taxable.

Toilet articles and perfumes.—Toilet articles, such as soaps and perfumes, are taxable at the rate of 2 per cent of the price for which they are sold by the manufacturer, producer or importer. Among such taxable articles are shaving soap, toilet soap, Ivory and Pear's soaps, petroleum jellies for toilet purposes, and chipped soap in barrels or kegs for export. All soaps advertised or held out to be suitable for soilet purposes or for application to the body or any part of the body as a cleansing agent are included.

All hair tonics are specifically taxed.

Raw materials, such as rose oil, etc., to be manufactured into perfumes, etc., are not taxable. Neither are floor oils, floor wax, kitchen soap powders and other articles used exclusively for household and not for toilet purposes.

Containers of perfumes, etc., if billed and shipped separately are not taxable, but if sold together with the perfume the tax attaches upon the combined price of container and perfume.

Medicinal preparations, etc.—The taxability of a medicinal substance or preparation is determined by the way it is prepared or marketed. Where taxable, the

rate is 2 per cent of the selling price. Preparations intended for beasts are taxable if the same would be taxable when used by man. A medicinal preparation is taxable if sold under any trade mark or trade name; it is held to be a medicinal preparation if recommended as a cure or remedy for any sickness or disease, and is taxable. This applies even if recommended only to physicians, as it is a recommendation intended to reach the public through the physician. If, however, it is recommended only for purposes other than medicinal, as for its food value, the tax does not attach. Insecticides, for example, are not taxable.

Licorice, when put up in any form suitable for medicinal purposes and sold under a trademark, is taxable, even though not recommended as a medicinal preparation.

A retail dealer, manufacturing a patent medicine by a private formula, must pay the tax, even though he sells the product only in his retail store. Where medicinal preparations are sold under labels which do not indicate that the formula is published, they will be construed to be prepared under secret formulas, unless an affidavit or other evidence is offered to show that the formula is not a secret.

Chewing gum.—On all chewing gum or substitutes therefor sold by manufacturer, producer or importer, there is a tax of 2 per cent of the price for which it is sold.

Cameras.—Cameras are taxable at the rate of 3 per cent. Process cameras are not taxable.

Returns.—The returns for the taxes described above are to be made in duplicate on or before the end of each month, showing the net sales for the preceding month, the amount of which is ascertained by deducting from the gross sales any trade discounts or other credits, such as credits for goods returned which had been sold in a previous month and tax thereon paid.

Penalties.—Penalty for failure to make return is a fine of not more than $1,000 or imprisonment for not more than one year, or both.

Penalty for failure to pay the tax, the return having been duly made, is 5 per cent of the amount of the tax plus interest at 1 per cent a month until tax is paid.

Yachts, etc.—The tax on pleasure boats, with the exception of those exempt, applies to all boats enumerated in section 603, whether in use or commission or not, if they are in fit condition for use. The tax is payable yearly in advance, the first tax period beginning October, 1917, and ending June 30, 1918. The tax will be paid on or before July 1 of each year following for succeeding fiscal years. In the case of the purchase of a new boat during the fiscal year, the tax is computed by multiplying one-twelfth of the annual tax by the number of months, including the month of purchase, remaining prior to July 1 following.

Tax returns are made on Form 732. The tax receipt (Form 725) must be kept on board when the boat is in use and shown upon demand to any Internal Revenue or Navigation officer.

The "user" of a boat is held to mean any person who purchases a vessel for his own use as distinguished from one who buys as a dealer.

Instructions for computing tonnage and over-all length will be found on Form 732.

The penalties provided for failure to make return and pay the tax are a fine of not more than $1,000 or imprisonment for not more than one year, or both. If the return has been made but payment of tax delayed, the penalty is 5 per cent of the amount of the tax and interest at 1 per cent per month.

CHAPTER XXIII

WAR EXCISE TAXES LAW

BEING TITLE VI OF "AN ACT TO PROVIDE REVENUE TO DEFRAY WAR EXPENSES, AND FOR OTHER PURPOSES," APPROVED OCTOBER 3, 1917. (PUBLIC—No. 50—65th CONGRESS.) IN EFFECT OCTOBER 4, 1917, UNLESS OTHERWISE SPECIALLY PROVIDED.

TITLE VI.—WAR EXCISE TAXES

Tax on sale or lease by manufacturer, producer, or importer.—Sec. 600 [of the general revenue Act of which this Title is a part]. That there shall be levied, assessed, collected, and paid—

Motor-driven vehicles.—(*a*) Upon all automobiles, automobile trucks, automobile wagons, and motorcycles, sold by the manufacturer, producer, or importer, a tax equivalent to three per centum of the price for which so sold; and

Mechanical musical instruments and records.—(*b*) Upon all piano players, graphophones, phonographs, talking machines, and records used in connection with any musical instrument, piano player, graphophone, phonograph, or talking machine, sold by the manufacturer, producer, or importer, a tax equivalent to three per centum of the price for which so sold; and

Moving-picture films.—(*c*) Upon all moving-picture films (which have not been exposed) sold by the manu-

facturer or importer, a tax equivalent to one-fourth of 1 cent per linear foot; and

(*d*) Upon all positive moving-picture films (containing a picture ready for projection) sold or leased by the manufacturer, producer or importer, a tax equivalent to one-half of 1 cent per linear foot; and

Jewelry—real or imitation.—(*e*) Upon any article commonly or commercially known as jewelry, whether real or imitation, sold by the manufacturer, producer, or importer thereof, a tax equivalent to three per centum of the price for which so sold; and

Sporting goods.—(*f*) Upon all tennis rackets, golf clubs, baseball bats, lacrosse sticks, balls of all kinds, including baseballs, foot balls, tennis, golf, lacrosse, billiard and pool balls, fishing rods and reels, billiard and pool tables, chess and checker boards and pieces, dice, games and parts of games, except playing cards and children's toys and games, sold by the manufacturer, producer, or importer, a tax equivalent to three per centum of the price for which so sold; and

Toilet preparations.—(*g*) Upon all perfumes, essences, extracts, toilet waters, cosmetics, petroleum jellies, hair oils, pomades, hair dressings, hair restoratives, hair dyes, tooth and mouth washes, dentifrices, tooth pastes, aromatic cachous, toilet soaps and powders, or any similar substance, article, or preparation by whatsoever name known or distinguished, upon all of the above which are used or applied or intended to be used or applied for toilet purposes, and which are sold by the manufacturer, importer, or producer, a tax equivalent to two per centum of the price for which so sold; and

Patent Medicines.—(*h*) Upon all pills, tablets, powders, tinctures, troches or lozenges, sirups, medicinal cordials or bitters, anodynes, tonics, plasters, liniments, salves, ointments, pastes, drops, waters (except those taxed under section three hundred and thirteen of this Act), essences, spirits, oils, and all medicinal prepara-

tions, compounds, or compositions whatsoever, the manufacturer or producer of which claims to have any private formula, secret, or occult art for making or preparing the same, or has or claims to have any exclusive right or title to the making or preparing the same, or which are prepared, uttered, vended, or exposed for sale under any letters patent, or trade-mark, or which, if prepared by any formula, published or unpublished, are held out or recommended to the public by the makers, venders, or proprietors thereof as proprietary medicines or medicinal proprietary articles or preparations, or as remedies or specifics for any disease, diseases, or affection whatever affecting the human or animal body, and which are sold by the manufacturer, producer, or importer, a tax equivalent to two per centum of the price for which so sold; and

Chewing gum.—(*i*) Upon all chewing gum or substitute therefor sold by the manufacturer, producer, or importer, a tax equivalent to two per centum of the price for which so sold; and

Cameras.—(*j*) Upon all cameras sold by the manufacturer, producer, or importer, a tax equivalent to three per centum of the price for which so sold.

Monthly returns.—Sec. 601. That each manufacturer, producer, or importer of any of the articles enumerated in section six hundred shall make monthly returns under oath in duplicate and pay the taxes imposed on such articles by this title to the collector of internal revenue for the district in which is located the principal place of business. Such returns shall contain such information and be made at such times and in such manner as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulations prescribe.

Floor tax on wholesaler's stocks.—Sec. 602. That upon all articles enumerated in subdivisions (*a*), (*b*), (*e*), (*f*), (*g*), (*h*), (*i*), or (*j*) of section six hundred, which

on the day this Act is passed are held and intended for sale by any person, corporation, partnership, or association, other than (1) a retailer who is not also a wholesaler, or (2) the manufacturer, producer, or importer thereof, there shall be levied, assessed, collected, and paid, a tax equivalent to one-half the tax imposed by each such subdivision upon the sale of the article therein enumerated. This tax shall be paid by the person, corporation, partnership, or association so holding such articles.

Administration of floor tax.—The taxes imposed by this section shall be assessed, collected, and paid in the same manner as provided in section ten hundred and two in the case of additional taxes upon articles upon which the tax imposed by existing law has been paid.

Exemption.—Nothing in this section shall be construed to impose a tax upon articles sold and delivered prior to May ninth, nineteen hundred and seventeen, where the title is reserved in the vendor as security for the payment of the purchase money.

Yachts, boats, etc.—Sec. 603. That on the day this Act takes effect, and thereafter on July first in each year, and also at the time of the original purchase of a new boat by a user, if on any other date than July first, there shall be levied, assessed, collected, and paid, upon the use of yachts, pleasure boats, power boats, and sailing boats, of over five net tons, and motor boats with fixed engines, not used exclusively for trade or national defense, or not built according to plans and specifications approved by the Navy Department, an excise tax to be based on each yacht or boat, at rates as follows: Yachts, pleasure boats, power boats, motor boats with fixed engines, and sailing boats, of over five net tons, length not over fifty feet, 50 cents for each foot, length over fifty feet and not over one hundred feet, $1 for each foot, length over one hundred feet, $2 for each foot;

motor boats of not over five net tons with fixed engines, $5.

Computation of tax.—In determining the length of such yachts, pleasure boats, power boats, motor boats with fixed engines, and sailing boats, the measurement of over-all length shall govern.

In the case of a tax imposed at the time of the original purchase of a new boat on any other date than July first, the amount to be paid shall be the same number of twelfths of the amount of the tax as the number of calendar months, including the month of sale, remaining prior to the following July first.

Approved by the President, October 3, 1917.

CHAPTER XXIV

TAX ON BEVERAGES LAW

BEING TITLE IV OF "AN ACT TO INCREASE THE REVENUE AND FOR OTHER PURPOSES," APPROVED SEPTEMBER 8, 1916. (PUBLIC—No. 271—64th CONGRESS.) IN EFFECT SEPTEMBER 9, 1916.

TITLE IV.—MISCELLANEOUS TAXES.

Taxable fermented liquors—Basis of tax.—Sec. 400 [of the general revenue Act of which this Title is a part]. That there shall be levied, collected, and paid a tax of $1.50 on all beer, lager beer, ale, porter, and other similar fermented liquor, brewed or manufactured and sold, or stored in warehouse, or removed for consumption or sale, within the United States, by whatever name such liquors may be called, for every barrel containing not more than thirty-one gallons; and at a like rate for any other quantity or for the fractional parts of a barrel authorized and defined by law. And section thirty-three hundred and thirty-nine of the Revised Statutes is hereby amended accordingly.

Wine defined.—Sec. 401. That natural wine within the meaning of this Act shall be deemed to be the product made from the normal alcoholic fermentation of the juice of sound, ripe grapes, without addition or abstraction, except such as may occur in the usual cellar treatment of clarifying and aging: Provided, however, That the product made from the juice of sound, ripe grapes

by complete fermentation of the must under proper cellar treatment and corrected by the addition (under the supervision of a gauger or storekeeper-gauger in the capacity of gauger) of a solution of water and pure cane, beet, or dextrose sugar (containing, respectively, not less than ninety-five per centum of actual sugar, calculated on a dry basis) to the must or to the wine, to correct natural deficiencies, when such addition shall not increase the volume of the resultant product more than thirty-five per centum, and the resultant product does not contain less than five parts per thousand of acid before fermentation and not more than thirteen per centum of alcohol after complete fermentation, shall be deemed to be wine within the meaning of this Act, and may be labeled, transported, and sold as "wine," qualified by the name of the locality where produced, and may be further qualified by the name of its own particular type or variety: And provided further, That wine as defined in this section may be sweetened with cane sugar or beet sugar or pure condensed grape must and fortified under the provisions of this Act, and wines so sweetened or fortified shall be considered sweet wine within the meaning of this Act.

Rates of tax and methods of payment.—Sec. 402. (*a*) That upon all still wines, including vermuth, and upon all artificial or imitation wines or compound sold as wine hereafter produced in or imported into the United States, and upon all like wines which on the date this section takes effect shall be in the possession or under the control of the producer, holder, dealer, or compounder there shall be levied, collected, and paid taxes at rates as follows:

On wines containing not more than fourteen per centum of absolute alcohol, 4 cents per wine gallon, the per centum of alcohol taxable under this section to be reckoned by volume and not by weight.

On wines containing more than fourteen per cen-

tum and not exceeding twenty-one per centum of absolute alcohol, 10 cents per wine gallon.

On wines containing more than twenty-one per centum and not exceeding twenty-four per centum of absolute alcohol, 25 cents per wine gallon.

All such wines containing more than twenty-four per centum of absolute alcohol by volume shall be classed as distilled spirits and shall pay tax accordingly: Provided, That on all unsold still wines in the actual possession of the producer at the time this title takes effect, upon which the tax imposed by the Act approved October twenty-second, nineteen hundred and fourteen, entitled "An Act to increase the internal revenue and for other purposes," and the joint resolution approved December seventeenth, nineteen hundred and fifteen, entitled "Joint resolution extending the provisions of the Act entitled 'An Act to increase the internal revenue, and for other purposes,' approved October twenty-second, nineteen hundred and fourteen, to December thirty-first, nineteen hundred and sixteen," has been assessed, the tax so assessed shall be abated, or, if paid, refunded under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe.

(*b*) That the taxes imposed by this section shall be paid by stamp on removal of the wines from the customhouse, winery, or other bonded place of storage for consumption or sale, and every person hereafter producing, or having in his possession or under his control when this section takes effect, any wines subject to the tax imposed in this section shall file such notice, describing the premises on which such wines are produced or stored; shall execute a bond in such form; shall make such inventories under oath; and shall, prior to sale or removal for consumption, affix to each cask or vessel containing such wine such marks, labels, or stamps as the Commissioner of Internal Revenue, with the ap-

proval of the Secretary of the Treasury, may from time to time prescribe; and the premises described in such notice shall, for the purpose of this section, be regarded as bonded premises. But the provisions of this subdivision of this section, except as to payment of tax and the affixing of the required stamps or labels, shall not apply to wines held by retail dealers, as defined in section thirty-two hundred and forty-four of the Revised Statutes of the United States, nor, subject to regulations prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall the tax imposed by this section apply to wines produced for the family use of the producer thereof and not sold or otherwise removed from the place of manufacture and not exceeding in any case two hundred gallons per year. The Commissioner of Internal Revenue is hereby authorized to have prepared and issue such stamps denoting payment of the tax imposed by this section as he may deem requisite and necessary; and until such stamps are provided the taxes imposed by this section shall be assessed and collected as other taxes are assessed and collected, and all provisions of law relating to assessment and collection of taxes, so far as applicable, are hereby extended to the taxes imposed by this section.

(*c*) That under such regulations and official supervision and upon the giving of such notices, entries bonds, and other security as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, any producer of wines defined under the provisions of this section or section four hundred and one of this Act, may withdraw from any fruit distillery or special bonded warehouse grape brandy, or wine spirits, for the fortification of such wines on the premises where actually made: *Provided,* That there shall be levied and assessed against the producer of such wines a tax of 10 cents per proof gallon

of grape brandy or wine spirits so used by him in the fortification of such wines during the preceding month, which assessment shall be paid by him within six months from the date of notice thereof: *Provided further,* That nothing herein contained shall be construed as exempting any wines, cordials, liqueurs, or similar compounds from the payment of any tax provided for in this section.

That sections forty-two, forty-three, and forty-five of the Act of October first, eighteen hundred and ninety, as amended by section sixty-eight of the Act of August twenty-seventh, eighteen hundred and ninety-four, are further amended to read as follows:

Amendment relating to wine spirits.—"Sec. 42. That any producer of pure sweet wines may use in the preparation of such sweet wines, under such regulations and after the filing of such notices and bonds, together with the keeping of such records and the rendition of such reports as to materials and products as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, wine spirits produced by any duly authorized distiller, and the Commissioner of Internal Revenue, in determining the liability of any distiller of wine spirits to assessment under section thirty-three hundred and nine of the Revised Statutes, is authorized to allow such distiller credit in his computations for the wine spirits withdrawn to be used in fortifying sweet wines under this Act.

Wine spirits defined and use regulated.—"Sec. 43. That the wine spirits mentioned in section forty-two herein mentioned is the product resulting from the distillation of fermented grape juice, to which water may have been added prior to, during, or after fermentation, for the sole purpose of facilitating the fermentation and economical distillation thereof, and shall be held to include the product from grapes or their residues commonly known as grape brandy, and shall include commercial grape brandy which may have been colored with burnt

sugar or caramel; and the pure sweet wine which may be fortified with wine spirits under the provisions of this Act is fermented or partially fermented grape juice only, with the usual cellar treatment, and shall contain no other substance whatever introduced before, at the time of or after fermentation, except as herein expressly provided: *Provided,* That the addition of pure boiled or condensed grape must or pure crystallized cane or beet sugar, or pure dextrose sugar containing, respectively, not less than ninety-five per centum of actual sugar, calculated on a dry basis, or water, or any or all of them, to the pure grape juice before fermentation, or to the fermented product of such grape juice, or to both, prior to the fortification herein provided for, either for the purpose of perfecting sweet wines according to commercial standards or for mechanical purposes, shall not be excluded by the definition of pure sweet wine aforesaid: *Provided,* however, That the cane or beet sugar, or pure dextrose sugar added for sweetening purposes shall not be in excess of eleven per centum of the weight of the wine to be fortified: And, *Provided further,* That the addition of water herein authorized shall be under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may from time to time prescribe: *Provided,* however, That records kept in accordance with such regulations as to the percentage of saccharine, acid, alcoholic, and added water content of the wine offered for fortification shall be open to inspection by any official of the Department of Agriculture thereto duly authorized by the Secretary of Agriculture; but in no case shall such wines to which water has been added be eligible for fortification under the provisions of this Act, where the same, after fermentation and before fortification, have an alcoholic strength of less than five per centum of their volume.

Withdrawal of wine spirits from bond.—"Sec. 45. That under such regulations and official supervision, and upon the execution of such entries and the giving of such bonds, bills of lading, and other security as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, any producer of pure sweet wines as defined by this Act may withdraw wine spirits from any special bonded warehouse in original packages or from any registered distillery in any quantity not less than eighty wine gallons, and may use so much of the same as may be required by him under such regulations, and after the filing of such notices and bonds and the keeping of such records and the rendition of such reports as to materials and products and the disposition of the same as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, in fortifying the pure sweet wines made by him, and for no other purpose, in accordance with the foregoing limitations and provisions; and the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is authorized whenever he shall deem it to be necessary for the prevention of violations of this law to prescribe that wine spirits withdrawn under this section shall not be used to fortify wines except at a certain distance prescribed by him from any distillery, rectifying house, winery, or other establishment used for producing or storing distilled spirits, or for making or storing wines other than wines which are so fortified, and that in the building in which such fortification of wines is practiced no wines or spirits other than those permitted by this regulation shall be stored in any room or part of the building in which fortification of wines is practiced. The use of wine spirits for the fortification of sweet wines under this Act shall be under the immediate supervision of an officer of internal revenue, who shall make returns

describing the kinds and quantities of wine so fortified, and shall affix such stamps and seals to the packages containing such wines as may be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury; and the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall provide by regulations the time within which wines so fortified with the wine spirits so withdrawn may be subject to inspection, and for final accounting for the use of such wine spirits and for rewarehousing or for payment of the tax on any portion of such wine spirits which remain not used in fortifying pure sweet wines."

(*d*) That under such regulations and upon the execution of such notices, entries, bonds, and other security as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, domestic wines subject to the tax imposed by this section may be removed from the winery where produced, free of tax, for storage on other bonded premises or from said premises to other bonded premises: *Provided,* That not more than one such additional removal shall be allowed, or for exportation from the United States or for use as distilling material at any regularly registered distillery: *Provided,* however, That the distiller using any such wine as material shall, subject to the provisions of section thirty-three hundred and nine of the Revised Statutes of the United States, as amended, be held to pay the tax on the product of such wines as will include both the alcoholic strength therein produced by fermentation and that obtained from the brandy or wine spirits added to such wines at the time of fortification.

(*e*) That upon all domestic and imported sparkling wines, liqueurs, cordials, and similar compounds remaining in the hands of dealers when this section takes effect, or thereafter removed from the place of manu-

facture or storage for sale or consumption, there shall be levied and paid, by stamp, taxes as follows:

On each bottle or other container of champagne or sparkling wine, 3 cents on each one-half pint or fraction thereof.

On each bottle or other container of artificially carbonated wine, $1\frac{1}{2}$ cents on each one-half pint or fraction thereof.

On each bottle or other container of liqueurs, cordials, or similar compounds, by whatever name sold or offered for sale, containing sweet wine, fortified with grape brandy under the provisions of paragraph (*c*) of this section, $1\frac{1}{2}$ cents on each one-half pint or fraction thereof.

The taxes imposed by this section shall not apply to wines, liqueurs, or cordials on which the tax imposed by the Act approved October twenty-second, nineteen hundred and fourteen, entitled "An Act to increase the internal revenue, and for other purposes," and the joint resolution approved December seventeenth, nineteen hundred and fifteen, entitled "Joint resolution extending the provisions of the Act entitled 'An Act to increase the internal revenue, and for other purposes,' approved October twenty-second, nineteen hundred and fourteen, to December thirty-first, nineteen hundred and sixteen," has been paid by stamp.

The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby authorized to have prepared suitable revenue stamps denoting the payment of the taxes imposed by this section; and all provisions of law relating to internal-revenue stamps, so far as applicable, are hereby extended to the taxes imposed by this section: *Provided,* That the collection of the tax herein prescribed on imported still wines, including vermouth, and sparkling wines, including champagne, and on imported liqueurs, cordials, and similar compounds, may be made

within the discretion of the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, by assessment instead of by stamps.

(*f*) That any person who shall evade or attempt to evade the tax imposed by this section, or any requirement of this section or regulation issued pursuant thereof, or who shall, otherwise than provided in this section, recover or attempt to recover any spirits from domestic or imported wine, or who shall rectify, mix, or compound with distilled spirits any domestic wines, other than in the manufacture of liqueurs, cordials, or similar compounds taxable under the provisions of this section, shall, on conviction, be punished for each such offense by a fine of not exceeding $5,000, or imprisonment for not more than five years, or both, and all wines, spirits, liqueurs, cordials, or similar compounds as to which such violation occurs shall be forfeited to the United States. But the provision of this subdivision of this section and the provision of section thirty-two hundred and forty-four of the Revised Statutes of the United States, as amended, relating to rectification, or other internal-revenue laws of the United States, shall not be held to apply to or prohibit the mixing or blending of wines subject to tax under the provisions of this section with each other or with other wines for the sole purpose of perfecting such wines according to commercial standards: *Provided,* That nothing herein contained shall be construed as prohibiting the use of tax-paid grain or other ethyl alcohol in the fortification of sweet wines as defined in section fifty-three [401?] of this Act.

(*g*) That the Commissioner of Internal Revenue, by regulations to be approved by the Secretary of the Treasury, may require the use at each fruit distillery of such spirit meters, and such locks and seals to be affixed to fermenters, tanks, or other vessels and to such pipe connections as may in his judgment be

necessary or expedient; and the said commissioner is hereby authorized to assign to any such distillery and to each winery where wines are to be fortified such number of gaugers or storekeeper-gaugers in the capacity of gaugers as may be necessary for the proper supervision of the manufacture of brandy or the making or fortifying of wines subject to tax imposed by this section; and the compensation of such officers shall not exceed $5 per diem while so assigned, together with their actual and necessary traveling expenses, and also a reasonable allowance for their board bills, to be fixed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, but not to exceed $2.50 per diem for said board bills.

(*h*) That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby authorized to make such allowances for unavoidable loss of wines while on storage or during cellar treatment as in his judgment may be just and proper, and to prepare all necessary regulations for carrying into effect the provisions of this section.

(*i*) That the second paragraph of section thirty-two hundred and sixty-four, Revised Statutes of the United States of America, as amended by section five of the Act of March first, eighteen hundred and seventy-nine, and as further amended by the Act of Congress approved June twenty-second, nineteen hundred and ten, be amended so as to read as follows:

"In all surveys forty-five gallons of mash or beer brewed or fermented from grain shall represent not less than one bushel of grain, and seven gallons of mash or beer brewed or fermented from molasses shall represent not less than one gallon of molasses, except in distilleries operated on the sour-mash principle, in which distilleries sixty gallons of beer brewed or fermented from grain shall represent not less than one bushel of grain, and except that in distilleries where

the filtration-aeration process is used, with the approval of the Commissioner of Internal Revenue; that is, where the mash after it leaves the mash tub is passed through a filtering machine before it is run into the fermenting tub, and only the filtered liquor passes into the fermenting tub, there shall hereafter be no limitation upon the number of gallons of water which may be used in the process of mashing or filtration for fermentation; but the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, in order to protect the revenue, shall be authorized to prescribe by regulation, to be made by him, such character of survey as he may find suitable for distilleries using such filtration-aeration process. The provisions hereof relating to filtration-aeration process shall apply only to sweet-mash distilleries."

Spirits removed for export.—Sec. 403. That under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, alcohol or other distilled spirits of a proof strength of not less than one hundred and eighty degrees intended for export free of tax may be drawn from receiving cisterns at any distillery, or from storage tanks in any distillery warehouse, for transfer to tanks or tank cars for export from the United States, and all provisions of existing law relating to the exportation of distilled spirits not inconsistent herewith shall apply to spirits removed for export under the provisions of this Act.

Amendment exempting certain distillers.—Sec. 404. That section thirty-two hundred and fifty-five of the Revised Statutes as amended by Act of June third, eighteen hundred and ninety-six, and as further amended by Act of March second, nineteen hundred and eleven, be further amended so as to read as follows:

"Sec. 3255. The Commissioner of Internal Revenue,

with the approval of the Secretary of the Treasury, may exempt distillers of brandy made exclusively from apples, peaches, grapes, pears, pineapples, oranges, apricots, berries, plums, pawpaws, persimmons, prunes, figs, or cherries from any provision of this title relating to the manufacture of spirits, except as to the tax thereon, when in his judgment it may seem expedient to do so: *Provided,* That where, in manufacture of wine, artificial sweetening has been used the wine or the fruit pomace residuum may be used in the distillation of brandy, as [and?] such use shall not prevent the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, from exempting such distiller from any provision of this title relating to the manufacture of spirits, except as to the tax thereon, when in his judgment it may seem expedient to do so: And, *Provided further,* That the distillers mentioned in this section may add to not less than five hundred gallons (or ten barrels) of grape cheese not more than five hundred gallons of a sugar solution made from cane, beet, starch, or corn sugar, ninety-five per centum pure, such solution to have a saccharine strength of not to exceed ten per centum, and may ferment the resultant mixture on a winery or distillery premises, and such fermented product shall be regarded as distilling material."

Gin bottled in bond for export.—Sec. 405. That distilled spirits known commercially as gin of not less than eighty per centum proof may at any time within eight years after entry in bond at any distillery be bottled in bond at such distillery for export without the payment of tax, under such rules and regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe.

Amendment—Penalties for removal of fermented liquor tax unpaid.—Sec. 406. That section thirty-three hun-

dred and fifty-four of the Revised Statutes of the United States as amended by the Act approved June eighteenth, eighteen hundred and ninety, be, and is hereby, amended to read as follows:

"Sec. 3354. Every person who withdraws any fermented liquor from any hogshead, barrel, keg, or other vessel upon which the proper stamp has not been affixed for the purpose of bottling the same, or who carries on or attempts to carry on the business of bottling fermented liquor in any brewery or other place in which fermented liquor is made, or upon any premises having communication with such brewery, or any warehouse, shall be liable to a fine of $500, and the property used in such bottling or business shall be liable to forfeiture: *Provided,* however, That this section shall not be construed to prevent the withdrawal and transfer of unfermented, partially fermented, or fermented liquors from any of the vats in any brewery by way of a pipe line or other conduit to another building or place for the sole purpose of bottling the same, such pipe line or conduit to be constructed and operated in such manner and with such cisterns, vats, tanks, valves, cocks, faucets, and gauges, or other utensils or apparatus, either on the premises of the brewery or the bottling house and with such changes of or additions thereto, and such locks, seals, or other fastenings, and under such rules and regulations as shall be from time to time prescribed by the Commissioner of Internal Revenue, subject to the approval of the Secretary of the Treasury, and all locks and seals prescribed shall be provided by the Commissioner of Internal Revenue at the expense of the United States. *Provided further,* That the tax imposed in section thirty-three hundred and thirty-nine of the Revised Statutes of the United States shall be paid on all fermented liquor removed from a brewery to a bottling house by means of a pipe or conduit, at the time of such removal, by the

cancellation and defacement, by the collector of the district or his deputy, in the presence of the brewer, of the number of stamps denoting the tax on the fermented liquor thus removed. The stamps thus canceled and defaced shall be disposed of and accounted for in the manner directed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury. And any violation of the rules and regulations hereafter prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, in pursuance of these provisions, shall be subject to the penalties above provided by this section. Every owner, agent, or superintendent of any brewery or bottling house who removes, or connives at the removal of, any fermented liquor through a pipe line or conduit, without payment of the tax thereon, or who attempts in any manner to defraud the revenue as above, shall forfeit all the liquors made by and for him, and all the vessels, utensils, and apparatus used in making the same."

Sec. 407. [Occupational taxes, including excise tax on corportions. See page 471.]

Sec. 408. [Special tax on tobacco manufacturers. See page 473.]

Administration.—Sec. 409. That all administrative or special provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this title, and every person, firm, company, corporation, or association liable to any tax imposed by this title, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may from time to time prescribe.

Act of October 22, 1914, repealed in part.—Sec. 410. That the Act approved October twenty-second, nine-

teen hundred and fourteen, entitled, "An Act to increase the internal revenue, and for other purposes," and the joint resolution approved December seventeenth, nineteen hundred and fifteen, entitled "Joint resolution extending the provisions of the Act entitled 'An Act to increase the internal revenue, and for other purposes,' approved October twenty-second, nineteen hundred and fourteen, to December thirty-first, nineteen hundred and sixteen," are hereby repealed, except sections three and four of such Act as so extended, which sections shall remain in force till January first, nineteen hundred and seventeen, and except that the provisions of the said Act shall remain in force for the assessment and collection of all special taxes imposed by sections three and four thereof, or by such sections as extended by said joint resolution, for any year or part thereof ending prior to January first, nineteen hundred and seventeen, and of all other taxes imposed by such Act, or by such Act as so extended, accrued prior to the taking effect of this title, and for the imposition and collection of all penalties or forfeitures which have accrued or may accrue in relation to any of such taxes.

Redemption of unused stamps.—Sec. 411. That the Commissioner of Internal Revenue, subject to regulation prescribed by the Secretary of the Treasury, may make allowance for or redeem stamps, issued, under authority of the Act approved October twenty-second, nineteen hundred and fourteen, entitled "An Act to increase the internal revenue, and for other purposes," and the joint resolution approved December seventeenth, nineteen hundred and fifteen, entitled "Joint resolution extending the provisions of the Act entitled 'An Act to increase the internal revenue, and for other purposes,' approved October twenty-second, nineteen hundred and fourteen, to December thirty-first, nineteen hundred and sixteen," to denote the payment of

internal revenue tax, and which have not been used, if presented within two years after the purchase of such stamps.

Act effective on day following passage.—Sec. 412. That the provisions of this title shall take effect on the day following the passage of this Act, except where otherwise in this title provided.

Sec. 413. [Leaves of absence for internal revenue officers.]

Invalidating Clause.

Sec. 900 [of the general revenue Act of which the above Title IV is a part]. That if any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of said Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered.

Sec. 902. That unless otherwise herein specially provided this Act shall take effect on the day following its passage, and all provisions of any Act or Acts inconsistent with the provisions of this Act, are hereby repealed.

Approved by the President, September 8, 1916.

TITLE III.—WAR TAX ON BEVERAGES [1]

Additional tax on distilled spirits.—Sec. 300 [of the general revenue Act of which this Title is a part]. That on and after the passage of this Act there shall be levied and collected on all distilled spirits in bond

[1] War Tax on Beverages. Being Title III of "An Act to Provide Revenue to Defray War Expenses, and for Other Purposes." Approved October 3, 1917. (Public—No. 50—65th Congress.) In effect October 4, 1917, unless otherwise specially provided.

at that time or that have been or that may be then or thereafter produced in or imported into the United States, except such distilled spirits as are subject to the tax provided in section three hundred and three, in addition to the tax now imposed by law, a tax of $1.10 (or, if withdrawn for beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage, a tax of $2.10) on each proof gallon, or wine gallon when below proof, and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the distiller or importer when withdrawn and collected under the provisions of existing law.

Additional tax on imported perfumes containing distilled spirits.—That in addition to the tax under existing law there shall be levied and collected upon all perfumes hereafter imported into the United States containing distilled spirits, a tax of $1.10 per wine gallon, and a proportionate tax at a like rate on all fractional parts of such wine gallon. Such tax shall be collected by the collector of customs and deposited as internal-revenue collections, under such rules and regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury may prescribe.

Importing of distilled spirits for beverage purposes prohibited.—Sec. 301. That no distilled spirits produced after the passage of this Act shall be imported into the United States from any foreign country, or from the West Indian Islands recently acquired from Denmark (unless produced from products the growth of such islands, and not then into any State or Territory or District of the United States in which the manufacture or sale of intoxicating liquor is prohibited), or from Porto Rico, or the Philippine Islands. Under such rules, regulations, and bonds as the Secretary of the Treasury may prescribe, the provisions of this section shall not apply to distilled spirits imported for other than (1)

beverage purposes or (2) use in the manufacture or production of any article used or intended for use as a beverage.

Removal of spirits from registered distilleries.—Sec. 302. That at registered distilleries producing alcohol, or other high-proof spirits, packages may be filled with such spirits reduced to not less than one hundred proof from the receiving cisterns and tax paid without being entered into bonded warehouse. Such spirits may also be transferred from the receiving cisterns at such distilleries, by means of pipe lines, direct to storage tanks in the bonded warehouse and may be warehoused in such storage tanks. Such spirits may be also transferred in tanks or tank cars to general bonded warehouses for storage therein, either in storage tanks in such warehouses or in the tanks in which they were transferred. Such spirits may also be transferred after tax payment from receiving cisterns or warehouse storage tanks to tanks or tank cars and may be transported in such tanks or tank cars to the premises of rectifiers of spirits. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby empowered to prescribe all necessary regulations relating to the drawing off, transferring, gauging, storing and transporting of such spirits; the records to be kept and returns to be made; the size and kind of packages and tanks to be used; the marking, branding, numbering and stamping of such packages and tanks; the kinds of stamps, if any, to be used; and the time and manner of paying the tax; the kind of bond and the penal sum of same. The tax prescribed by law must be paid before such spirits are removed from the distillery premises, or from general bonded warehouse in the case of spirits transferred thereto, except as otherwise provided by law.

Warehouse regulations.—Under such regulations as the Commissioner of Internal Revenue, with the approval

of the Secretary of the Treasury, may prescribe, distilled spirits may hereafter be drawn from receiving cisterns and deposited in distillery warehouses without having affixed to the packages containing the same distillery warehouse stamps, and such packages, when so deposited in warehouse, may be withdrawn therefrom on the original gauge where the same have remained in such warehouse for a period not exceeding thirty days from the date of deposit.

Exemptions relating to ethyl and denatured alcohol.—Under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, the manufacture, warehousing, withdrawal, and shipment, under the provisions of existing law, of ethyl alcohol for other than (1) beverage purposes or (2) use in the manufacture or production of any article used or intended for use as a beverage and denatured alcohol, may be exempted from the provisions of section thirty-two hundred and eighty-three, Revised Statutes of the United States.

Regulations in manufacture of ethyl alcohol.—Under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, manufacturers of ethyl alcohol for other than beverage purposes may be granted permission under the provisions of section thirty-two hundred and eighty-five, Revised Statutes of the United States, to fill fermenting tubs in a sweet-mash distillery not oftener than once in forty-eight hours.

Floor tax imposed upon stocks of distilled spirits.—Sec. 303. That upon all distilled spirits produced in or imported into the United States upon which the tax now imposed by law has been paid, and which, on the day this Act is passed, are held by a retailer in a quantity in excess of fifty gallons in the aggregate, or by any other person, corporation, partnership, or association in any quantity, and which are intended for

sale, there shall be levied, assessed, collected, and paid a tax of \$1.10 (or, if intended for sale for beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage, a tax of \$2.10) on each proof gallon, and a proportionate tax at a like rate on all fractional parts of such proof gallon: Provided, That the tax on such distilled spirits in the custody of a court of bankruptcy in insolvency proceedings on June first, nineteen hundred and seventeen, shall be paid by the person to whom the court delivers such distilled spirits at the time of such delivery, to the extent that the amount thus delivered exceeds the fifty gallons hereinbefore provided.

War tax on rectified distilled spirits and wines.—Sec. 304. That in addition to the tax now imposed or imposed by this Act on distilled spirits there shall be levied, assessed, collected, and paid a tax of 15 cents on each proof gallon and a proportionate tax at a like rate on all fractional parts of such proof gallon on all distilled spirits or wines hereafter rectified, purified, or refined in such manner, and on all mixtures hereafter produced in such manner, that the person so rectifying, purifying, refining, or mixing the same is a rectifier within the meaning of section thirty-two hundred and forty-four, Revised Statutes, as amended, and on all such articles in the possession of the rectifier on the day this Act is passed:

Provided, That this tax shall not apply to gin produced by the redistillation of a pure spirit over juniper berries and other aromatics.

Dilution prohibited.—When the process of rectification is completed and the tax prescribed by this section has been paid, it shall be unlawful for the rectifier or any other dealer to reduce in proof or increase in volume such spirits or wine by the addition of water or other substance; nothing herein contained shall, however, prevent a rectifier from using again in the

process of rectification spirits already rectified and upon which the tax has theretofore been paid.

Exemptions from war tax.—The tax imposed by this section shall not attach to cordials or liqueurs on which a tax is imposed and paid under the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, nor to the mixing and blending of wines, where such blending is for the sole purpose of perfecting such wines according to commercial standards, nor to blends made exclusively of two or more pure straight whiskies aged in wood for a period not less than four years and without the addition of coloring or flavoring matter or any other substance than pure water and if not reduced below ninety proof: *Provided,* That such blended whiskies shall be exempt from tax under this section only when compounded under the immediate supervision of a revenue officer, in such tanks and under such conditions and supervision as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe.

Distilled spirits subject to uniform regulations.—All distilled spirits taxable under this section shall be subject to uniform regulations concerning the use thereof in the manufacture, blending, compounding, mixing, marking, branding, and sale of whiskey and rectified spirits, and no discrimination whatsoever shall be made by reason of a difference in the character of the material from which same may have been produced.

Rectifier subject to regulations of Commissioner of Internal Revenue.—The business of a rectifier of spirits shall be carried on, and the tax on rectified spirits shall be paid, under such rules, regulations, and bonds as may be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury.

Penalties.—Any person violating any of the provisions of this section shall be deemed to be guilty of a misdemeanor and, upon conviction, shall be fined not more than $1,000 or imprisoned not more than two years. He shall, in addition, be liable to double the tax evaded together with the tax, to be collected by assessment or on any bond given.

Stamp regulations.—Sec. 305. That hereafter collectors of internal revenue shall not furnish wholesale liquor dealer's stamps in lieu of and in exchange for stamps for rectified spirits unless the package covered by stamp for rectified spirits is to be broken into smaller packages.

The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is authorized to discontinue the use of the following stamps whenever in his judgment the interests of the Government will be subserved thereby:

Distillery warehouse, special bonded warehouse, special bonded rewarehouse, general bonded warehouse, general bonded retransfer, transfer brandy, export tobacco, export cigars, export oleomargarine and export fermented liquor stamps.

Commissioner may require installation of revenue-protecting apparatus.—Sec. 306. That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby authorized to require at distilleries, breweries, rectifying houses, and wherever else in his judgment such action may be deemed advisable, the installation of meters, tanks, pipes, or any other apparatus for the purpose of protecting the revenue, and such meters, tanks, and pipes and all necessary labor incident thereto shall be at the expense of the person, corporation, partnership, or association on whose premises the installation is required. Any such person, corporation, partnership, or association refusing or neglecting to install such

apparatus when so required by the commissioner shall not be permitted to conduct business on such premises.

War tax on beer, ale, porter, etc.—Sec. 307. That on and after the passage of this Act there shall be levied and collected on all beer, lager beer, ale, porter, and other similar fermented liquor, containing one-half per centum or more of alcohol, brewed or manufactured and sold, or stored in warehouse, or removed for consumption or sale, within the United States, by whatever name such liquors may be called, in addition to the tax now imposed by law, a tax of $1.50 for every barrel containing not more than thirty-one gallons, and at a like rate for any other quantity or for the fractional parts of a barrel authorized and defined by law.

Removal from brewery to distillery.—Sec. 308. That from and after the passage of this Act taxable fermented liquors may be conveyed without payment of tax from the brewery premises where produced to a contiguous industrial distillery of either class established under the Act of October third, nineteen hundred and thirteen, to be used as distilling material, and the residue from such distillation, containing less than one-half of one per centum of alcohol by volume, which is to be used in making beverages, may be manipulated by cooling, flavoring, carbonating, settling, and filtering on the distillery premises or elsewhere.

The removal of the taxable fermented liquor from the brewery to the distillery and the operation of the distillery and removal of the residue therefrom shall be under the supervision of such officer or officers as the Commissioner of Internal Revenue shall deem proper, and the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby authorized to make such regulations from time to time as may be necessary to give force and effect to this section and to safeguard the revenue.

Tax doubled on still wines, champagnes, etc.—Sec. 309. That upon all still wines, including vermuth, and upon all champagne and other sparkling wines, liqueurs, cordials, artificial or imitation wines or compounds sold as wine, produced in or imported into the United States, and hereafter removed from the custom-house, place of manufacture, or from bonded premises for sale or consumption, there shall be levied and collected, in addition to the tax now imposed by law upon such articles, a tax equal to such tax, to be levied, collected, and paid under the provisions of existing law.

Floor tax on excess stocks of still wines, etc.—Sec. 310. That upon all articles specified in section three hundred and nine upon which the tax now imposed by law has been paid and which are on the day this Act is passed held in excess of twenty-five gallons in the aggregate of such articles add intended for sale, there shall be levied, collected, and paid a tax equal to the tax imposed by such section.

Withdrawal of grape brandy or wine spirits.—Sec. 311. That upon all grape brandy or wine spirits withdrawn by a producer of wines from any fruit distillery or special bonded warehouse under subdivision (*c*) of section four hundred and two of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, there shall be levied, assessed, collected, and paid in addition to the tax therein imposed, a tax equal to double such tax, to be assessed, collected, and paid under the provisions of existing law.

Floor tax on sweet wines as fortified.—Sec. 312. That upon all sweet wines held for sale by the producer thereof upon the day this Act is passed there shall be levied, assessed, collected, and paid an additional tax equivalent to 10 cents per proof gallon upon the grape brandy or wine spirits used in the fortification of such wine, and an additional tax of 20 cents per proof

gallon shall be levied, assessed, collected, and paid upon all grape brandy or wine spirits withdrawn by a producer of sweet wines for the purpose of fortifying such wines and not so used prior to the passage of this Act.

Sirups and extracts in manufacture of soft drinks.—Sec. 313. That there shall be levied, assessed, collected, and paid—

(*a*) Upon all prepared sirups or extracts (intended for use in the manufacture or production of beverages, commonly known as soft drinks, by soda fountains, bottling establishments, and other similar places) sold by the manufacturer, producer, or importer thereof, if so sold for not more than $1.30 per gallon, a tax of 5 cents per gallon; if so sold for more than $1.30 and not more than $2 per gallon, a tax of 8 cents per gallon; if so sold for more than $2 and not more than $3 per gallon, a tax of 10 cents per gallon; if so sold for more than $3 and not more than $4 per gallon, a tax of 15 cents per gallon; and if so sold for more than $4 per gallon, a tax of 20 cents per gallon; and

Soft drinks.—(*b*) Upon all unfermented grape juice, soft drinks or artificial mineral waters (not carbonated), and fermented liquors containing less than one-half per centum of alcohol, sold by the manufacturer, producer, or importer thereof, in bottles or other closed containers, and upon all ginger ale, root beer, sarsaparilla, pop, and other carbonated waters or beverages, manufactured and sold by the manufacturer, producer, or importer of the carbonic acid gas used in carbonating the same, a tax of 1 cent per gallon; and

Natural mineral or table waters.—(*c*) Upon all natural mineral waters or table waters, sold by the producer, bottler, or importer thereof, in bottles or other closed containers, at over 10 cents per gallon, a tax of 1 cent per gallon.

Monthly returns by manufacturer, bottler, importer, etc., of sirups, soft drinks, and natural mineral waters.—Sec. 314. That each such manufacturer, producer, bottler, or importer shall make monthly returns under oath to the collector of internal revenue for the district in which is located the principal place of business, containing such information necessary for the assessment of the tax, and at such times and in such manner, as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe.

Carbonic Acid Gas.—Sec. 315. That upon all carbonic acid gas in drums or other containers (intended for use in the manufacture or production of carbonated water or other drinks) sold by the manufacturer, producer, or importer thereof, there shall be levied, assessed, collected, and paid a tax of 5 cents per pound. Such tax shall be paid by the purchaser to the vendor thereof and shall be collected, returned, and paid to the United States by such vendor in the same manner as provided in section five hundred and three.

Approved by the President, October 3, 1917.

CHAPTER XXV

WAR STAMP TAXES

What is taxed.—Bonds of indebtedness, debentures or certificates of indebtedness; bonds of indemnity and surety; capital stock issues; capital stock sales and transfers; produce sales on exchanges or boards of trade; drafts or checks payable otherwise than at sight or on demand; promissory notes; conveyances; deeds; instruments conveying lands, tenements or other realty; entry of goods at customhouse, entry for withdrawal of goods from customs bonded warehouses; passage tickets to foreign ports except in Canada or Mexico; voting proxies; powers of attorney; and parcels post packages are subject to a stamp tax on and after December 1, 1917, under Title VIII of the Act of October 3, 1917.

Playing cards are also subjected to an additional tax, effective on and after Oct. 4, 1917.

The rate of tax and method of payment in each case will be given in following sections of this chapter, each class of document or article subject to tax being treated in a separate section.

Who pays the tax.—In the case of documents requiring the tax stamp affixed, the tax is intended to be paid by the person[1] who makes or issues the instrument, but the penalty provided is equally upon the person who accepts a taxable instrument upon which the tax stamps have not been duly affixed.

In the case of parcel post packages, the tax is paid

[1] "Person" includes "corporation," "partnership," and association.

by the sender of the package, and without the payment of the tax the package will not be transported.

In the case of playing cards the tax is to be paid by the manufacturer or importer.

Exemptions.—The tax does not attach to any bond, note or other instrument issued by the United States or by any foreign government, or by any State, Territory or the District of Columbia or local subdivision thereof, or municipal or other corporation exercising the taxing power, when issued in the exercise of a strictly governmental, taxing or municipal function.

Bonds given by officials of a State, township, county or village, for the faithful performance of duties, and any bonds given to the same political subdivisions covering contracts for governmental purposes or the protection of the State, township, county, village or municipality, in any respect, are held to be free from Federal taxation on the broad ground that the sovereign States and subdivisions thereof are constitutionally free from taxation by the Federal Government. This ruling does not apply to bonds otherwise taxable given to the Federal Government for any purpose.

Government officers and employees should be careful not to pay the tax, as they can not be reimbursed by the Department of Commerce for such payments inadvertently made.

Exemption is provided also for stocks and bonds issued by coöperative building and loan associations which are organized and operated exclusively for the benefit of their members and make loans only to their shareholders. Stocks and bonds issued by mutual ditch or irrigating companies are also exempt.

Checks and drafts payable at sight or on demand are not taxed. This exemption does not apply, however, to promissory notes.

Bank notes intended for circulation are exempt.

Bonds of indebtedness.—Tax is imposed on bonds of indebtedness as follows: "Bonds, debentures or certificates of indebtedness issued on and after the first day of December, nineteen hundred and seventeen, by any person, corporation, partnership or association, on each $100 of face value or fraction thereof, 5 cents: Provided, that every renewal of the foregoing shall be taxed as a new issue: Provided, further, that when a bond conditioned for the repayment or payment of money is given in a penal sum greater than the debt secured, the tax shall be based upon the amount secured."

A bond is a written promise, under seal, to pay a specified sum of money at a fixed time in the future, and, in the case of corporate or municipal issues, is usually one of a series of similar bonds all carrying interest at a fixed rate. Each bond contains certain provisons as to the time, place and manner of these payments, and usually refers to the mortgage, if any, made to insure their fulfillment or to the law, if any, authorizing the issue.

While bonds may be issued by individuals, partnerships and associations, as well as by corporations, their use is largely confined to corporations (and government or municipal bodies), since the length of time usually involved makes the bonds of an individual, in the judgment of the market, an uncertain investment.

The tax on bonds is only upon issue or renewal on and after December 1, 1917. Subsequent sale or transfer of the bond is not taxable.

"Issue" means the first delivery of the instrument, complete in form, to the person who takes it as a holder.

"Renewal," strictly speaking, refers to a new issue supplanting the old, in which some change is made in the agreement, as to time of payment, rate of interest, security or other matters. It is to be presumed that extended bonds will be classed as renewed, for the purpose of the tax. Extended or continued bonds may be, for example, either (1) a new issue with extended date of

maturity given to the holders of outstanding bonds in exchange for the old ones, in a reorganization or readjustment of a corporation, or (2) the same bonds may be retained and coupons issued for an additional interest period. Bonds are then "stamped."

A literal construction of the clause in regard to renewal of bonds, etc., "Provided further, that every renewal of the foregoing shall be taxed as a new issue," would impose the renewal tax only upon the "foregoing," which word refers, literally, to "bonds, debentures or certificates of indebtedness issued on and after December 1, 1917." Under such a construction, renewals of bonds which were first issued prior to that date would not be taxable, but it is held that the intent of the law was to tax all renewals of bonds, regardless of when the bonds were first issued.

In the case of organization or reorganization of a corporation, "temporary bonds" may be issued, pending the issue of the regular bonds. Such interim or temporary bonds are really a substitute for the permanent bond, and contain the essential recitals. They would be taxable, and if the tax were duly paid, might be sold or transferred or exchanged for the regular bonds, either by the original owner or by a new owner, without additional tax, since the tax does not attach to sale or transfer of a bond, and it would therefore not attach to the sale or transfer of a substitute for the bond.

Temporary receipts would be classed with temporary bonds and be subject to the same conditions. A temporary receipt, strictly speaking, is a formal acknowledgment by a banking house, trust company or the issuing corporation of the payment for a bond not yet prepared for delivery and the promise to deliver the bond, when prepared, on surrender of the receipt at the proper offices. The distinction ordinarily made between a temporary receipt and a temporary bond is that the latter

is not merely an acknowledgment of value received, but is a substitute for the regular bond.

Certificates of deposit of money issued by banks and trust companies are not taxable, whether they are time certificates or whether they contain a certain clause reserving the right of requiring thirty days' notice for payment.

Certificates of deposit issued by a depositary upon receiving bonds or other securities deposited under a reorganization agreement would, generally speaking, be taxable if designed to serve as a substitute for a taxable security. There is no tax upon a contract or agreement by a corporation to issue stock.

Debentures.—Although in England the term "debenture" implies a charge upon property of the issuing corporation, the word is used in the United States to designate a bond without specific security, which rests merely upon the general credit of the company. This is not true of debentures of a financial company, however, which are by law required to be secured. Debentures are classed with bonds for the purpose of the tax, which attaches, as in the case of bonds, only upon issue or renewal, and not upon subsequent sale or transfer.

Certificates of indebtedness.—Certificates of indebtedness, as contemplated by the tax, are formally executed corporate promises to pay a fixed sum of money in the future. If such certificates are issued under seal and have a far-distant date of maturity they would be classed with bonds. Short term promises to pay, not under seal, would be classed as promissory notes.

Trust certificates, stock trust certificates and stock interest certificates.—The foregoing should be classed with bonds where there is an obligation cited to pay principal, interest or both.

Indemnity and surety bonds.—The tax on bonds for indemnifying any person or concern as surety, and on bonds for the due performance of contracts, when no

premium or fee is paid for the issuance of the bond, is 50 cents for each bond.

If a premium is charged for the execution of the bond, the tax is based on the amount of the premium and is at the rate of 1 cent for each $1 or fractional part thereof of the premium charged. The rate and amount of premium charged should be stated on the bond, so that correctness of tax may be verified. Policies of reinsurance are exempt. Bonds required in legal proceedings are not taxable.

Capital stock—original issue.—Stock certificates, evidencing the stockholder's ownership interest in the issuing association, company or corporation, are taxable, like bonds, at the time of issue or renewal, and in addition, are taxable upon sale or transfer. In the case of capital stock with face value, issued upon organization or upon reorganization of any non-exempt association, company or corporation on or after December 1, 1917, a tax is imposed of 5 cents for each $100 or fraction thereof of face value. In the case of stock without face, or par, value, the tax is 5 cents for each share, provided, that if the actual market value of such stock exceeds $100 per share the tax will be 5 cents for each $100 or fraction thereof of the total actual value.

For example, in the case of stock with face value, the basis of the tax would be the total face value of the shares issued, regardless of the face value of the individual shares, which might be $5, $50 or $100, without affecting the amount of the tax. In the case of non-par shares, however, if the actual value is less than $100 per share, the tax is 5 cents upon each individual share.

In all cases of issue of capital stock, the stamps denoting the payment of the tax must be attached to the stock books and not to the certificates themselves. Where there are no stubs or stock books, but loose certificates are issued, the stamps must be affixed to the books of record in which the issues are recorded.

Ad interim stock certificates.—Issues of interim certificates, that is, certificates entitling the holder thereof to receive stock when, as and if issued, pending stock issue of corporations organized or reorganized on or after December 1, 1917, are subject to a tax of 5 cents on each $100 of face value or fraction thereof. Subsequent exchange of such interim for regular stock certificates will not be subject to tax, but if meanwhile the interim certificate is sold or transferred a sale or transfer tax must be paid. There is no stamp tax upon articles of incorporation, applications for the issuance of corporate charters, contracts for the performance of services, or upon contracts or agreements by a corporation to issue stock.

Capital stock sales, transfers, or agreements to sell.—A tax of 2 cents on each $100 of face value or fraction thereof, or in the case of stock without par value, 2 cents on each share, or if value exceeds $100 per share, 2 cents upon each $100 of actual value, or fraction thereof, is imposed upon all sales, or agreements to sell, or memoranda of sales or deliveries of, or transfer of legal title to shares of certificates of stock in any association, company or corporation, whether made upon or shown by the books of the company, or by assignment in blank, or by any delivery, paper, agreement, memorandum or other evidence of transfer or sale, whether entitling the holder in any manner to the benefit of such stock or not.

In computing the tax on such sales or transfers of stock, the basis is the total face, or par, value of all the shares involved in a single transaction, even though the shares are represented by several different certificates. The amount of the tax would be the same upon a transfer of ten $50 shares as it would be upon that of five $100 shares, that is 10 cents, or 2 cents for each $100 of face value or fraction thereof.

It must be noted, however, that in the case of stock without face, or par, value, the tax upon sale or transfer

is 2 cents for each share, unless the actual value of each share exceeds $100, in which case the tax is the same as upon shares with face value—2 cents for each $100 or fraction thereof involved in the total transaction. The valuation of non-par stock is to be determined by the actual, sale, or market value.

The tax upon transfer or sale of stock must be paid regardless of whether the transfer is made before or after the issuance of the original certificate.

Where a corporation organized under the laws of Canada or any other foreign country issues stock in the United States on and after December 1, 1917, such stock is subject to tax.

The tax is not imposed upon the deposit of stock certificates as collateral security for money loaned thereon nor upon an agreement relating to such deposit, unless the stock is actually sold, nor is the tax imposed upon deliveries or transfers to a broker for sale, nor upon the delivery or transfer of stock purchased by a broker, to his customer. Such deliveries or transfers, however, must be accompanied by a certificate setting forth the facts. Of course, at the time a broker sells the stock he has received from his customer, a tax must be paid. This may be paid by the broker, who later charges his customer with the amount of the tax.

Where stock is transferred on the books of the company, the stamps must be placed upon the books. Where transfer is merely by delivery of the certificate, the stamp must be placed upon the certificate itself.

In case of agreement to sell, as well as in the case of transfer by assignment in blank, the seller must make and deliver to the buyer a memorandum or bill of sale or agreement to sell, to which the stamps must be affixed, and such bill or agreement must show the date thereof, the name of the seller, the amount of the sale and the matter or thing to which it refers.

Where title passed in the transfer of stock prior to

December 1, 1917, no tax accrues, even though the actual physical transfer of the stock certificates was not made to the transferee or on the books of the corporation until after that date.

In cases where *A* owns a certificate of 100 shares of stock and transfers 50 shares of this stock to *B,* and there are two certificates of 50 shares each issued in lieu of the 100-share certificate, 50 shares going to *A* and 50 shares going to *B,* the tax is imposed only upon the transfer of the 50 shares to *B,* there being no tax on *A's* transfer to himself.

The procedure in the collection of stamp taxes on sales and transfers of shares of stock and like securities is given in detail in Part I of Regulations 40, reprinted herewith, explanatory subject-captions being inserted for the convenience of the reader.

TREASURY DEPARTMENT REGULATIONS No. 40

PART I

Regulations Promulgated by the Commissioner of Internal Revenue, with the Approval of the Secretary of the Treasury, for Collection of Stamp Taxes on Sales and Transfers of Shares of Stock and Like Securities

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Definitions

Sales and transfers.—Article 1. That for the purpose of these regulations, the term "sales or transfers" shall be held to include all sales, agreements to sell, memoranda of sales, and all deliveries or transfers of legal title, except as otherwise specifically provided in these regulations.

Person.—That the word "person" or "every person" or similar term whenever used in these regulations shall

include the plural as well as the singular, and shall be taken to refer to individuals, partnerships, associations, and corporations, except where it is plain from the context that a different meaning is intended.

Exchange.—That wherever the word "exchange" is used in these regulations, except as otherwise specifically indicated, it shall be deemed and taken to include each and every agent or agency, auction place or other meeting place at which stocks are publicly bought, sold, bid for, offered, or exchanged, either between the members or patrons of such exchange, or as between members and nonmembers, patrons and the public, and it shall include all incorporated and unincorporated associations of individuals, partnerships, and corporations engaged in the business of publicly selling, buying, or exchanging shares of stock or interests therein.

Shares of stock.—The term "share or shares of stock," when used in these regulations, except as otherwise therein specifically defined, shall be held and taken to mean and include the shares and certificates for shares of stock representing interests in corporations, and in incorporated and unincorporated associations, as well as voting trust certificates for shares, and certificates for shares or interests in shares, "if, as, and when issued," and for "rights" therein.

Clearing house.—The terms "clearing house," "clearing house corporation," and "clearing house association," shall be held and taken to mean and include each and every incorporated and unincorporated association of individuals, partnerships, and corporations wholly or partly engaged in the business of clearing, settling, or adjusting transactions in the purchase, sale, receipt, or delivery of shares of stock, whether or not the same be a part or department of an exchange or an independent body.

Responsibility for compliance with tax provisions.—The act, omission, or failure of any official, agent, or

other person acting for or employed by any association, partnership, or corporation within the scope of his employment or office, shall, in every case, also be deemed the act, omission, or failure of such association, partnership, or corporation, as well as that of the person or persons.

Registration

Who must register.—Art. 2. Every person, partnership, corporation, exchange, or clearing house engaged in whole or in part in negotiating, making, or recording sales, agreements to sell, deliveries or transfers of shares or certificates for shares of stock, or in conducting or transacting a stock-brokerage business, or in the clearing, settling, or adjusting of any of the transactions referred to in section 807, subdivision 4, of the act, or who shall be engaged in the business of accepting or procuring the transmission of orders for the sale or purchase or transfers of stock to be made or executed at or under the rules or customs of an exchange in the continental United States, shall,

Time of registration.—On the first day of December, 1917—and if not on that date engaged in business, then within ten days after engaging in business, and on the first day of July annually thereafter—

Place of registry.—File in the office of the collector of internal revenue of the district in which each place of business of such person, partnership, corporation, exchange, or clearing house is located, or with such other internal-revenue officer as may be hereafter designated,

Contents of registration statement.—A statement, under oath, setting forth the full name or names of such person or persons, and of all the members of such partnership conducting or transacting the business, with the post-office address or addresses of such person or persons, or partnership, unless the person so certifying be a corporation, exchange, or clearing house, in which

event it shall set forth its principal office or place of business, with the names and addresses of its chief officer, its secretary, accompanied by a list of its members and their addresses, and if incorporated, when and where incorporated, and if not incorporated, under what agreement or authority it is conducting such business or agency. Such statement shall also specifically set forth the character of the business to be conducted,

Signatures required.—And shall be executed and duly acknowledged by the person or persons so conducting or intending to conduct said business, or by the president or secretary of the corporation or exchange or clearing house.

Constitution and by-laws.—Each exchange or clearing house shall also file with said collector or other designated internal-revenue officer a copy of its constitution, charter, agreement of association, by-laws, rules and regulations, and of all amendments thereto, as the same may from time to time be adopted,

New members.—And the names and addresses of new members as from time to time admitted to membership.

Licenses.—The said statement shall further contain information as to whether the person executing the same has been licensed under any State laws or under any other provision of Federal law; and if so, the dates and places at which any such licenses were issued.

Official form supplied by collector.—Such statements shall be made upon forms to be furnished upon application to the collector of internal revenue.

Record of Registration Kept by Collector

Records preserved by collector.—Art. 3. Every collector or other designated internal-revenue officer shall file and preserve each statement of registration made to him in accordance with these regulations,

Certificate of registry issued by collector.—And shall issue to such person, partnership, exchange, clearing

house, or corporation a certificate of registry, showing the date of issue, the name of the person or persons, or exchange, clearing house, or corporation, conducting the business, the nature of the business for which the license is granted, and the date of expiration of said registry, which certificate shall be signed by the collector or other designated internal-revenue officer,

Certificate to be posted in place of business.—And shall be posted in some prominent place in the office of said person, partnership, exchange, clearing house, or corporation during the period for which issued. If such business is conducted at more than one place, a certificate shall be so posted in each such place of business.

Rate of Taxation

Tax on transfer of stock with face value.—Art. 4. In the case of shares or certificates of stock having a face (or par) value, the amount of the tax shall be based upon the total face value of the shares involved in any sale or agreement to sell or memorandum of sale, delivery, or transfer, and shall be at the rate of 2 cents for each $100 of such total face value or fraction thereof, whether such aggregate face value is greater or less than $100. Thus where the total face value of the shares or certificates of stock, agreement to sell, or memorandum of sale involved in any such transaction is less than $100, the amount of such tax shall be 2 cents; where the total face value exceeds $100 but is $200 or less, the amount of such tax shall be 4 cents;

Non-par stock.—And where such shares of stock are without face (or par) value, the tax shall be 2 cents on the transfer or sale or agreement to sell on each share, unless the actual value thereof is in excess of $100 per share, in which case the tax shall be 2 cents on each $100 of actual value or fraction thereof.

Transactions Not Taxable

No tax on deposit of stock as collateral.—Art. 5. No tax is imposed upon an agreement evidencing a deposit of stock certificates as collateral security for money loaned thereon, which stock certificates are not actually sold or intended to be sold nor as to which there is no change of ownership or interest nor upon such stock certificates so deposited.

No tax on transfer to or by a broker.—Nor upon deliveries or transfer to a broker for sale, nor upon deliveries or transfers by a broker to a customer for whom and upon whose order he has purchased the same,

Certificate to be signed by broker.—Provided such deliveries or transfers shall be accompanied in each case by a certificate setting forth the facts, such certificates to be substantially in the following form:

(*a*) (In the case of a transfer to a broker)—

> "We hereby certify that we have no ownership, or interest, in * * * shares of the stock above transferred, the transfer by the owner to us being merely for the purpose of sale."

(*b*) (In the case of a transfer by a broker)—

> "We hereby certify that the transfer of * * * of the within shares to the names indicated by the star is made solely to complete the purchase made by us for our customer, and we have no ownership or interest therein."

No broker who has filed a certificate under the foregoing clause (*a*) of this ruling shall file a certificate under the foregoing clause (*b*) with reference to the transfer of any shares of stock covered by the certificate filed by him under clause (*a*).

No tax on clearing house adjustments.—Nor upon transfers or deliveries to a clearing house for the sole purpose of clearing or adjusting accounts between members, where no beneficial interest is vested in said clearing house or clearing association and there has been no change of title or interest: *Provided,*

Transactions of members to be reported to clearing house.—The exchange shall by appropriate by-laws or regulations require from its members that all transactions of such members in shares of stock be promptly reported to such clearing house to the end that the stamp taxes thereon may be collected and that no other clearances or settlements or trading in balances shall be permitted. All transactions, actual or otherwise, except as in the act are exempt, shall be subject to the tax.

Administrative provision.—No provision, by-law, rule, or custom of any exchange, or similar institution, inconsistent with any requirement or provision of the act or any regulations thereunder, nor any collateral or additional agreement or understanding, either verbal or written, respecting the subject matter of such sales or transfers, or the settlement or fulfillment thereof, which is inconsistent or in conflict with any requirement of said act or of these regulations, shall exempt any person from the payment of the tax provided for under said act.

Delivery of Memorandum of Sales

Each taxable transaction must include memorandum.—Art. 6. Every person who makes sales, or agreements to sell, or memoranda of sales or deliveries of, or transfers of the legal or beneficial title to shares of stock, at, in or on any exchange or similar place of business, and every person who makes any agreement to sell stock or makes a transfer of stock by delivery of the certificate therefor assigned in blank, shall as a part of every such transaction, promptly make and deliver to the buyer a bill, or memorandum of sale, or agreement to sell,
Signatures.—Duly signed by the principal or his agent,
Contents.—Which shall show the date of the transaction evidenced by it, the names of the seller and buyer, the shares of stock to which it relates, the number of shares and the price per share of said stock,

Each memorandum to be numbered.—And shall bear a number upon the face thereof.

Separate number for each memorandum.—No more than one such bill or memorandum made by the seller on any given day shall bear the same number: *Provided, however,*

One stamped memorandum for each transaction.—That no single transaction of a purchase or sale that is made upon an exchange by one member for another member shall require to be evidenced by more than one stamped memorandum of sale or agreement to sell.

Affixing and Cancellation of Stamps

Transfer by assignment in blank.—Art. 7. In case the transfer is effected by delivery of the certificate of stock assigned in blank the stamp shall be affixed to the bill, memorandum, or agreement to sell.

Transfer by delivery of certificate.—In case the change of ownership is by transfer of the certificate of stock, the stamp shall be affixed to the certificate, and in no event shall any company or registrar or transfer agent accept or transfer any shares of stock or certificates therefor unless stamps for all transfer tax required to be affixed to the certificate are attached thereto properly canceled.

Transfer on company's books.—In case the evidence of the transfer is shown only by the books of the company the stamp shall be placed upon the books.

Agreement.—In all other cases the payment shall be evidenced by affixing the stamp upon the memorandum or agreement of sale to be delivered by the seller to the buyer.

Method of cancellation.—The person using or affixing a stamp shall write or stamp thereon, in ink, his initials and the day, month, and year on which the same shall be used or affixed, or shall by cutting or cancelling said stamp with a machine or punch affixing his initials and

date as aforesaid, so deface the stamp as to render it unfit for reuse. In addition to the foregoing, stamps of the value of 10 cents or more shall have three parallel incisions made by some sharp instrument lengthwise through the stamp after the same has been attached to the bill, memorandum, or other evidence of sale or transfer of stock, provided this will not be required where stamps are canceled by perforation. The cancellation by either method should not so deface the stamp as to prevent its denomination and genuineness from being readily determined.

Records of Sales or Transfers of Stock

Transactions to be recorded.—Art. 8. All persons who are wholly or partly engaged in the business of buying, selling, or transferring shares of stock, whether at public or private sale, or whether or not they are members of an exchange, including persons engaged in transactions known as "matched," or "on-order," or "pass-outs," or by any other name or term at, on, or in any exchange or similar place, whether or not such transactions are cleared, adjusted, or settled through a clearing house or directly between seller and buyer, or otherwise,

Contents of record.—Shall keep a record showing—

(a) The date of the transaction.

(b) The name of the seller or transferror.

(c) The name of the purchaser or transferee.

(d) If the order was executed on an exchange, the name of the person who executed the order.

(e) Whether the transaction is a purchase or sale.

(f) The name of the corporation the stock of which is the subject of the sale and the number of shares thereof.

(g) Whether the stock was listed on an exchange.

(h) Whether the stock was cleared through a clearing house.

(i) The face or par value of the stock.

(j) The price of the stock if there is no face or par value.

(k) Whether the shares were borrowed or loaned.

(l) Whether the transaction was "matched," "on-order," a "pass-out," or a "scratched sale," or any other kind of sale or purchase.

(m) The amount of tax paid.

(n) The identifying number of the bill or memorandum of sale, as required by article 6 of these regulations.

(o) The origin of the order, whether domestic (referring to the Continental United States), or foreign (referring to other countries).

Records to be in book form and kept two years.—Persons using such forms may incorporate therein additional columns that would be of use to them, such columns to be placed after the columns containing the information herein required, so as not to interfere with the columns and headings hereby prescribed. These records must be in book form, and all entries therein must be legibly written in ink and the records kept for a period of at least two years. Such record forms will not be supplied by the department.

Prescribed form of record.—The form of record required shall be as follows:

Returns by Persons Making Sales

Who makes return.—Art. 9. All persons who are wholly or partly engaged in the business of buying, selling, or transferring shares of stock at, in, or on an exchange, whether or not such sales, purchases, or transfers shall be made, cleared, settled, or adjusted through a clearing house; shall

Time and place of filing return.—On or before the fifteenth day of each month, and at any other time or times that may be designated by the Commissioner of Internal

Revenue, render under oath a true return of all such sales and purchases to said commissioner for the preceding month or for any other period designated by the commissioner,

Contents of return.—Containing in detail the following data and information:

(a) The month for which the return is made.

(b) The name and address of the person, partnership, corporation, or association making the return.

(c) The number of shares of stock sold and purchased on such exchange and cleared by its clearing agency or association.

(d) The number of shares of stock sold and purchased on such exchange that were not cleared by its clearing agency or association.

(e) In respect of shares having a face (or par) value:

- (1) The aggregate face value of all shares, not including any fraction of less than $100 of face value involved in any transaction.
- (2) The number of fractions of less than $100 of face value involved in all transactions.

(f) In respect of shares having no face (or par) value:

- (1) As to such shares of an actual value in excess of $100 per share—
  - (A) The aggregate actual value of all shares, not including any fraction of less than $100 involved in any transaction.
  - (B) The number of fractions of less than $100 involved in all transactions in such shares.
- (2) As to such shares of an actual value of $100 or less per share—
  - (A) The total number of such shares.

(g) As to shares purchased, the same information and detail required for shares sold, transferred, and delivered required under (e) and (f) for shares sold, transferred, or delivered.

(h) The number of shares of stock borrowed.

(i) The number of shares of stock loaned.

(j) The number of shares of loaned stock returned.

(k) The number of shares of borrowed stock returned.

(l) The amount of tax paid.

(m) The amount in dollars of stamps purchased during the month.

(n) The amount in dollars of stamps on hand on the last day of the month for which return is being made.

Forms furnished.—Such returns shall be made upon forms furnished upon application by the internal revenue collector or other designated officer.

Commissioner may require returns for any transactions.—The Commissioner of Internal Revenue may, from time to time, require any person wholly or partly engaged in the business of buying, selling, or transferring shares of stock, whether at public or private sale, and whether or not such sale shall be made on an exchange or cleared, settled, or adjusted through a clearing house to render under oath returns of all such transactions upon forms prescribed by him.

Returns by Clearing Houses

Clearing house to file return.—Art. 10. Every clearing house or committee or body through or by which clearing is done shall,

Time of filing.—On or before the fifteenth day of each month, and at any other time designated by the Commissioner of Internal Revenue, render in writing under oath to the Commissioner of Internal Revenue a return for the preceding month, or for any other period that may be designated by the Commissioner,

Contents of return.—Of all facts in their possession relating to any and all such transactions, and showing in detail:

(a) The month for which return is made;
(b) The name and address of the clearing house or similar business, agency, or institution making the return; and
(c) The number of shares of stock directed to be received and the number of shares of stock directed to be delivered and cleared, settled, or adjusted for each member during the month or period for which the return is made.

Forms.—Such return shall be made upon the forms to be furnished upon application by the collector of internal revenue or other designated officer.

Member's daily written report to clearing house deemed to be the taxable memorandum.—If any person who negotiates sales or transfers of stock on a stock exchange, shall appoint in writing the clearing house for such exchange upon which such sale or transfers are made, if any, his agent for the purposes hereinafter indicated, such clearing house being approved by the Commissioner of Internal Revenue, and shall make a written return, statement or sheet, to such clearing house containing a full disclosure on each business day of all such transactions, both such as are clearable and non-clearable, of the preceding day in shares of stock that are listed or permitted to be dealt in by such member on such exchange, also which if any of such stocks are loaned or borrowed, then in that event such return, statement, or sheet delivered to the clearing house shall be deemed to be the bill, or memorandum of sale, or agreement to sell, required under section 807, subdivision 4, of the act approved October 3, 1917,

Clearing house may affix and cancel stamps as member's agent.—And such clearing house is hereby authorized to

affix to such return, statement, or sheet the amount of stamps required for each sale or agreement to sell or memorandum of sale for delivery or transfer of such stock indicated thereon, and to cancel the stamp so affixed. The affixing and cancellation of such stamps by the clearing house shall be held to be that of the person making such sale or agreement to sell, or memorandum of sale, for delivery or transfer of such stock.

Contents of member's memorandum report to clearing house.—The returns, statements, or sheets made to the clearing house shall in respect of each sale show the date thereof, the name of the seller, the name of the buyer, the amount of the sale, and the name of the stock, certificates, voting shares, or other things traded in, but a return for more than one sale may be upon the same return, statement, or sheet,

Transactions must be fully disclosed.—And no settlement of differences or other dealings between members shall be permitted that will interfere with the full disclosure of the whole transaction.

Tax paid sheets to be kept two years.—Said clearing house shall preserve the returns, statements, or sheets so made and stamped for at least two years.

Monthly return to be made by seller to Commissioner of Internal Revenue.—But such return, statement, or sheet to the clearing house shall not relieve the person from making the monthly return required by these regulations.

Clearing house must keep records of transfers of customers' accounts.—Wherever any clearing house association or similar body carries upon its sheets or records information or reports of transactions showing the transfer by one of its members of an account of a customer without change of ownership of the securities of the customer, there shall be kept by the members of such clearing house or body concerned in such transaction, a record showing the particulars of such transaction.

Substitute Returns—Agents

In default of return, internal revenue officer may inspect books and make return.—Art. 11. If any person or clearing house required to make any return by law, or the regulations thereunder, shall fail or refuse to make such return within the time prescribed, such return may be made by an internal revenue officer, upon inspection of the books and papers of the person or clearing house required to make such returns; but the making of such return by an internal revenue officer shall not relieve the person or clearing house in default from any penalty incurred by reason of the failure to make such return.

Authority of commissioner or agent.—Any officer designated by the Commissioner of Internal Revenue shall have authority to examine the books, papers, and records kept pursuant to these regulations and may require the production of any other books, records, papers, or statements of account, necessary to determine any liability to the tax imposed by the act, or to the observance of the provisions of the regulations made in accordance therewith.

Sale of Stamps

Who may sell stamps.—Art. 12. No person other than a collector of internal revenue, or duly authorized deputy collector of internal revenue, an Assistant Treasurer, or other United States designated depositary shall sell or expose for sale, give away, traffic in, trade, barter, lend, borrow, or exchange any stamp, issued pursuant to these regulations. No person shall buy or receive any such stamps or have the same in his possession or under his control, unless such stamps have been purchased directly from the collector of internal revenue, Assistant Treasurer, or other United States designated depositary, in the district in which the stamps are to be used.

Requisitions for stamps.—All requisitions for stamps to be used under these regulations shall be made in writing, in ink, on a form prescribed by the Commissioner of Internal Revenue, to the collector of internal revenue, or to an Assistant Treasurer, or other designated depositary, in the internal-revenue district in which the stamps are to be used, giving the date thereof, the number and denomination of stamps applied for, and the name and address of the purchaser, and shall be signed in ink by the person receiving the stamps.

Record of requisitions to be kept by collector.—The collector of internal revenue to whom such requests are made shall keep a record thereof, and shall keep the requisitions separate and apart from all other requisitions for stamps, and preserve them in his office for a period of two years. Any Assistant Treasurer or designated depositary of the United States receiving requisitions for such stamps shall keep a record of each such requisition and at the end of each month shall file such requisitions with his monthly report to the collector of internal revenue of the district in which said Assistant Treasurer or other designated depositary is located.

Kinds of stamps.—The stamps to be used under these regulations shall be of such kind and color as are prescribed by the Commissioner of Internal Revenue.

Note

Administrative provisions.—For the provisions as to fines and penalties applying particularly to violations or attempted evasions of the act or of these regulations, reference is made to sections 802, 803, 807, subdivisions 4 and 5, and 1004 of the "Act to provide revenue to defray war expenses and for other purposes," approved October 3, 1917. The provisions of the internal-revenue laws of the United States, so far as applicable, including sections 3173, 3174 and 3175, of the Revised Statutes, as amended, apply to said act.

Sales of products or merchandise on exchange for future delivery.—A tax of 2 cents for each $100 in value is imposed upon all sales of produce or merchandise on exchanges or boards of trade for future delivery. Cash sales, for immediate or prompt delivery of products or merchandise actually intended to be delivered, are not subject to the tax. Agreements to sell, including so-called transferred or "scratch sales," are likewise taxable, substantially as provided in the case of agreements, etc., relating to the sale of stock, as enumerated hereinbefore.

It is provided that sellers of commodities who have duly paid the tax may transfer their contracts to a clearing house for the adjustment and balancing of the accounts of the members of the clearing house association on their several contracts and that such transfer will not be taxable, provided, however, that the transfer invests no beneficial interest in the clearing house association.

The following are the Treasury Department Regulations relating to the stamp tax upon sales of products or merchandise on exchanges for future delivery.

TREASURY DEPARTMENT REGULATIONS No. 40

PART II

Regulations Promulgated by the Commissioner of Internal Revenue, with the Approval of the Secretary of the Treasury, for the Collection of Stamp Taxes Upon Sales of Products or Merchandise on Exchanges for Future Delivery

Definitions

Sale.—Art. 1. That for the purposes of these regulations the term "sale" or "contract of sale" shall be held to include all sales, or agreements of sale, or agreements to sell, including so-called transfers or "scratched sales."

Person.—The word "person" or "every person," or similar term, whenever used in these regulations, shall include the plural as well as the singular, and shall be taken to refer to individuals, partnerships, associations, and corporations, except where it is plain from the context that a different meaning is intended.

Exchange.—The word "exchange" as used in these regulations, except as otherwise specifically indicated in the regulations, shall be deemed and taken to include each and every agent or agency, auction place, or other meeting place at which produce or merchandise for future delivery is publicly bought, sold, bid for, offered, or exchanged, or contracts for such future delivery are made, either between the members or patrons of such exchange, or as between members and nonmembers, patrons, and the public, and it shall include all incorporated and unincorporated associations of individuals, partnerships, and corporations engaged in the business of publicly selling, buying, or exchanging products or merchandise for future delivery.

Clearing house.—The term "clearing house" shall be held to mean each and every clearing-house corporation, clearing-house association, or incorporated and unincorporated association, carried on for the purpose of clearing, settling, and adjusting transactions in purchasing, selling, receiving, or delivering products or merchandise, whether such clearing house be a part or department of an exchange or an independent body.

Responsibility for compliance with tax provisions.—The act, omission, or failure of any official, agent, or other person acting or employed by any person, association, partnership, or corporation, within the scope of his employment or office, shall in every case also be deemed the act, omission, or failure of such person, association, partnership, or corporation.

Registration

Who must register.—Art. 2. Every person engaged in whole or in part in making contracts of sale of any product or merchandise or commodity at, on, or in, or under the rules or customs of any exchange for future delivery, or engaged in the business of accepting or procuring the transmission of such contracts of sale, to be executed on any exchange, and every exchange and every clearing house shall,

Time of registration.—On the first day of December, 1917, and if not on that date engaged in business, then within ten days after engaging in business, and on the first day of July annually thereafter file

Place of registration.—In the office of the collector of internal revenue of the district in which each place of business of such person, exchange, or clearing house is located, or with such other internal-revenue officer as may be hereafter designated,

Contents of Statement.—A statement under oath setting forth the full name of such person, if an individual, and if a partnership the full names of all the members of such partnership, with the post-office address of the individual or partnership; and if the person filing such statement be a corporation or association it shall set forth its principal office or place of business with the names and addresses of its chief officer and its secretary, accompanied by a list of its members and their addresses, and if incorporated, when and where incorporated, and if unincorporated, under what agreement or authority it is conducting business, together with a copy of such agreement.

Signatures required.—Statements filed in behalf of any corporation, association, exchange, or clearing house shall be executed and duly acknowledged by the president or secretary thereof.

Information required of exchange or clearing house.—

Every statement filed by an exchange or clearing house shall specifically set forth the character of the business conducted or intended to be conducted. Each exchange and clearing house shall also file with the said collector or other designated internal-revenue officer a copy of its constitution, charter, agreement of association, by-laws, and regulations, and all amendments thereto, as the same may from time to time be adopted, and the names and addresses of new members as from time to time admitted to membership.

Forms.—The statements required by these regulations shall be made upon forms to be prescribed by the Commissioner of Internal Revenue.

Records and Certificates

Records kept by collector.—Art. 3. Every collector of internal revenue or other designated internal-revenue officer shall file and preserve each statement or registration made to him in accordance with these regulations,
Certificate issued by collector.—And shall issue to the person making such statement a certificate of registry showing the date of issue, the name of the person, the nature of the business for which the certificate is granted, and the date of the expiration of the registration, which certificate shall be signed by the collector or other designated internal-revenue officer,
Certificate to be posted in place of business.—And shall at all times during the period for which it is issued be posted in some prominent place in the office of the person receiving it. If the business of such person is conducted at more than one place, a certificate shall be so posted in each such place of business.

Transactions Not Taxable

Cash sales for prompt delivery exempt.—Art. 4. No tax is imposed on cash sales of products or merchandise for immediate or prompt delivery which in good faith

are actually intended to be delivered. All sales at an exchange for future delivery are subject to the payment of the tax.

"Delivery" defined.—For the purpose of these regulations "immediate or prompt delivery" shall mean delivery at once or as soon as practicable, and in any event within twenty days of the date of the sale or agreement. Every sale or agreement not evidenced by a memorandum or contract expressly requiring immediate or prompt delivery within the above definition shall be deemed to be for future delivery. In all cases in which the commissioner is not satisfied from the evidence submitted to him that the transaction was in good faith intended to be followed by immediate or prompt delivery, within the above definition, the seller shall be required to pay the tax as on a sale for future delivery.

Transfer to clearing house.—Sellers of products, merchandise, or commodities having paid the tax provided by law may transfer such contracts to a clearing-house association, and such transfer shall not be deemed to be a sale, or agreement of sale, or agreement to sell, within the provisions of the act, provided that such transfer does not vest any beneficial interest in the clearing house association and is made for the sole purpose of enabling such clearing-house association to adjust and balance the accounts of the members of said clearing-house association on their several contracts.

Administrative provisions. — No provision, by-law, rule, or custom of any exchange, board of trade, or similar institution or place of business which is inconsistent or in conflict with any requirement or provision of the "Act to provide revenue to defray war expenses, and for other purposes," approved October 3, 1917, or any regulations thereunder, nor any collateral, or additional agreement or understanding, either verbal or written, respecting the subject matter of such contract or the settlement or fulfillment thereof, which is inconsistent or

in conflict with any requirement of said act or the regulations thereunder promulgated by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall exempt any person from the payment of the tax provided for under section 807, subdivision 5, of said act.

Memoranda of Sales

Memorandum to be delivered by seller to buyer.—Art. 5. Every person who makes sales or contracts of sale of any product, merchandise, or commodity at, on, or in any exchange for future delivery, shall, except as herein otherwise expressly provided, deliver to the buyer a bill, memorandum, agreement, or other evidence of such sale or agreement of sale,

Contents of memorandum.—Which shall show the date thereof, the name of the seller, the name of the purchaser, the product, merchandise, or commodity, the quantity thereof to which it refers, the price, the aggregate amount of the sale, and the amount of the tax to be paid,

Tax stamps to be affixed.—To which bill, memorandum, agreement, or other evidence of sale there shall be affixed a lawful stamp or stamps in value equal to the amount of tax on such sale.

One stamped memorandum for each sale.—No single sale or contract of sale that is made upon an exchange by one member for another shall require to be evidenced by more than one such stamped memorandum.

Memorandum may be delivered to clearing house.—If any person making contracts of sale for future delivery of any products or merchandise at, in, or on any exchange shall in writing appoint the clearing house for the exchange upon which such sales are made his agent for the purposes hereinafter indicated, such clearing house being approved by the Commissioner of Internal Revenue, and shall make a written return or sheet of

each such sale to such clearing house in accordance with these regulations, the return or sheet of the person to the clearing house shall be deemed to be the bill, memorandum, or agreement of sale required to be delivered by the seller to the buyer,

Clearing house may pay tax.—And the clearing house is hereby authorized to affix to such return or sheet the amount of stamps required for each contract of sale indicated thereon, and to cancel the stamps so affixed; the affixing and cancellation of such stamps by the clearing house to be held to be that of the person making such contracts of sale.

Contents of return to clearing house.—The return or sheet of sales so made to the clearing house shall in respect of each sale set forth the date, the name of the seller, the name of the purchaser, the amount of the sale, and the matter or things to which it refers, but a return for more than one sale may be made upon the same paper or sheet.

Clearing house must preserve records for two years.—The clearing house shall preserve for a term of not less than two years each return or sheet made to it by any person under the foregoing regulations.

Clearing house report to Commissioner.—Every clearing house so acting shall include in the monthly return to the Commissioner a statement of the amounts of stamps so affixed and canceled for each person.

Monthly returns required of seller.—The making of such return by the clearing house shall not relieve the person making such sales from making the monthly return of his transactions required by these regulations.

Method of stamp cancellation.—The person using or affixing stamps shall write or stamp thereon in ink his initials and the day, month, and year on which the same shall be used or affixed, or shall, by cutting and canceling the stamp with a machine or punch affix his initials and date as aforesaid, so deface the stamp as to render it

unfit for reuse. In addition to the foregoing, stamps of the value of 10 cents or more shall have three parallel incisions made by some sharp instrument lengthwise through the stamp after the same has been attached to the document: *Provided,* This will not be required where stamps are canceled by perforation. The cancellation by either method should not so deface the stamp as to prevent its denomination and genuineness from being readily determined.

Records by Sellers and Buyers

Who must keep records, and of what.—Art. 6. All persons who make sales or contracts of sales, including so-called "transferred or scratch sales," "pass-outs," "pair-offs," or "matched trades," and all other forms of sale of any product or merchandise at, on, in, or under the rules, or customs of any exchange for future delivery shall keep a record showing:

(a) Date when contract was made.
(b) Name and address of the other party to the contract.
(c) Name of person executing the contract.
(d) Whether the transaction is a purchase or sale.
(e) Quantity of product, merchandise, or commodity involved; whether in tons, pounds, bales, bushels, bags, mats, barrels, gallons, or other unit of measure or weight, as the case may be.
(f) Name of product, merchandise, or commodity, including (if not a basis grade contract) grade, type, sample, or description.
(g) Name of customer.
(h) Whether the contract is a "basis grade" contract.
(i) Time specified in contract for delivery.
(j) Specified price per ton, pound, mat, bale, bag, bushel, barrel, gallon, or other unit of measure or weight, as the case may be.
(k) Gross amount of sale or purchase.

(l) Amount of tax paid.

(m) Whether the order for sale or purchase was of domestic (meaning the continental United States) or foreign origin (meaning from countries other than the continental United States).

(n) Date of delivery or settlement.

(o) Method of fulfillment or settlement.

Form of record.—Persons who use such forms may incorporate additional columns which would be of use to them, such columns to be placed in such positions as not to interfere with the columns and headings prescribed. Such record forms will not be supplied by the department.

The records required by these regulations shall be legibly written in ink and kept separate in books, and contracts of sale for future delivery of two or more distinct products or merchandise shall be kept separate.

Records preserved by seller.—Any person who executes or makes such contracts of sale shall preserve the trading cards, memoranda, or slips of each transaction,

Records preserved by purchaser.—And the purchaser shall preserve the bill, memorandum, or evidence of sale to which the stamps are affixed, for the period of two years.

Official form of record.—The form of the record required by these regulations shall be as follows:

Records to be Kept by Clearing Houses

Clearing house records.—Art. 7. All persons who act in the capacity of a clearing house or clearing association shall keep a record showing:

(a) Name of person for whom each contract is cleared.

(b) Date when contract was made.

(c) Whether the transaction is a purchase or sale.

(d) Quantity of product, merchandise, or commodity involved, whether in tons, pounds, bales, bush-

els, bags, mats, barrels, gallons, or other unit of measure or weight, as the case may be.

(e) Name of product, merchandise, or commodity, including (if not a basis-grade contract) grade, type, sample, or description.

(f) Whether the contract is a basis-grade contract.

(g) Time specified in contract for delivery.

(h) Date of settlement.

(i) Method of settlement.

Separate records for each product.—Records of sales for future delivery of two or more distinct products or merchandise must be kept separate.

Returns by Members of Exchanges

Returns required.—Art. 8. All persons who make contracts of sale of any commodity, product, or merchandise, at, on, or in any exchange, board of trade, or other similar place of business, for future delivery, whether such contracts shall be cleared and adjusted through a clearing house, or clearing association, or directly between the seller and buyer, or otherwise, shall

Time of return.—On or before the fifteenth day of each month, and at any other time required by the Commissioner of Internal Revenue, make return, in writing, to the Commissioner of Internal Revenue, or some officer designated by him, for the preceding month or any other period, verified before some officer authorized to administer oaths, showing:

Contents of return.—(a) The number of contracts of sale and purchase of each product, merchandise, or commodity brought forward from the preceding month.

(b) The number of contracts of sale and purchase of each product, merchandise, or commodity during the current month.

(c) The month in which the products, merchandise, or commodity is to be delivered.

(d) The method of settlement of each contract, i. e., whether by "actual delivery," "notice," "ring," "direct," "transfer," or "scratch sale," "pair off," or "matched," "pass out," "set off," "give up," through a clearing house or clearing association, or otherwise.

(e) The gross amount of the contracts of sale.

(f) The tax paid thereon.

(g) The number of contracts both of purchase and sale left open at the end of the month.

(h) The amount of stamps on hand from preceding month.

(i) The amount of stamps purchased during month.

(j) The amount of stamps used during month.

(k) Balance of stamps on hand at end of month.

(l) The origin of the order of the contracts, whether domestic or foreign.

Form of return.—Such returns shall be made upon forms to be furnished, upon application, by the collector of internal revenue, or other designated officer of the district in which the exchange, board of trade, or other similar place is located.

Returns by Clearing Houses

Returns required.—Art. 9. Every clearing house, or clearing association, shall,

Time of return.—On or before the 15th day of each month, and at any other time required, render in writing, under oath, a return, for the preceding month or for any other period designated, to the Commissioner of Internal Revenue of all facts in their possession showing:

Contents of return.—(a) The number of contracts "long" and "short" for each member brought forward from the preceding month.

(b) The number of contracts bought or sold by each member of the association.

(c) The number of tons, pounds, bales, bushels, bags, mats, barrels, or gallons, or other units of weight or measure involved in such contracts, as the case may be.

(d) The month in which such product, merchandise, or commodity is to be delivered.

(e) The method of settlement of said contracts—i. e., whether by "set-off," "notice," or "delivery," or by any other method.

(f) The number of open contracts "long" and "short" for each member carried to the following month.

Form of return.—Such returns shall be made upon forms to be furnished, upon application, by the collector of internal revenue of the district, or other designated officer, in which the clearing house or clearing association is situated.

Failure to Make Returns—Agents

In default of return, same may be made by internal revenue officer.—Art. 10. If any person, or clearing house, or clearing association, required to make returns by this act, or the regulations thereunder, shall fail, or refuse to make any return within the time prescribed in these regulations, or designated by the Commissioner of Internal Revenue, then the same shall be made by an internal-revenue officer, upon inspection of the books and papers of the person, or clearing house, or clearing association, so required;

Penalty attaches to such default.—But the making of said return by an internal-revenue officer shall not relieve the person in default from any penalty incurred by reason of his failure to make such return.

Authority of internal-revenue officer.—Any officer designated by the Commissioner of Internal Revenue shall have authority to examine the books, papers, and records kept pursuant to these regulations, and may require

the production of any other books, records, papers, or statements of account, necessary to determine any liability to the tax imposed by this act, or the observance of the provisions of the regulations made in accordance therewith.

Sale of Stamps

Who may sell stamps.—Art. 11. No persons other than a collector of internal revenue, or duly authorized deputy collector of internal revenue, assistant treasurer, or designated depositary of the United States, in the district in which is located an exchange, shall sell or expose for sale, traffic in, trade, barter, or exchange any stamp required by law or by these regulations to be used for the payment of taxes upon sales or contracts of sale of any product or merchandise for future delivery.

Requisitions for stamps.—All requisitions for such stamps shall be made in writing on a form prescribed by the Commissioner of Internal Revenue to the collector of internal revenue, an assistant treasurer, or designated depositary in the internal revenue district in which the stamps are to be used, giving the date thereof, the number and denomination of stamps applied for, and the name and address of the purchaser, and shall be signed in ink by the person receiving the stamps.

Records of requisitions.—If the requisition for such stamps shall be made to any assistant treasurer or designated depositary of the United States, such assistant treasurer or designated depositary shall keep a record thereof, and at the end of each month shall file such requisitions with his monthly report with the collector of internal revenue of the district in which said assistant treasurer or designated depositary is located. The collector of internal revenue shall keep the requisitions for such stamps made to him and those filed by such assistant treasurer or designated depositary separate and apart from all other requisitions for stamps and preserve them in his office for a period of two years.

Kind of stamps authorized.—The stamps shall be of a color and design prescribed by the Commissioner of Internal Revenue.

Note

Fines and penalties—enforcement.—For the provisions as to fines and penalties applying particularly to violations or attempted evasions of the act or of these regulations reference is made to sections 802, 803, 807, subdivision 5, and 1004 of the "Act to provide revenue to defray war expenses, and for other purposes," approved October 3, 1917. The provisions of the internal-revenue laws of the United States, so far as applicable, including sections 3173, 3174, 3175, of the Revised Statutes, as amended, apply to said act.

Time drafts, post-dated checks and promissory notes.—Drafts or checks payable otherwise than at sight or on demand, promissory notes (except bank notes issued for circulation), and each renewal of the same, are taxable as follows: for a sum not exceeding $100 or fractional part thereof, 2 cents, and for each additional $100 or fractional part thereof, 2 cents. A renewal, for the purpose of the tax, is any written agreement permitting an extension of the time of payment, whether a new note is made or not.

A promissory note is a written promise to pay a specified sum of money on demand or at a specified future time. The chief distinction between promissory notes and bonds, for the purpose of the tax, is that bonds are issued under seal, whereas notes are not.

Ordinary checks are not taxable. Checks dated ahead, however, are payable neither at sight or on demand and must therefore have stamp affixed.

Drafts drawn in foreign countries and payable in the United States are not subject to the tax.

Drafts drawn in the United States and payable in for-

eign countries are subject to the tax, if payable otherwise than on sight or on demand.

Drafts payable on "arrival of goods" and "at sight or on demand after arrival of goods," are subject to the tax.

Policy loan and premium extension agreements are not promissory notes within the meaning of the law and are not subject to the stamp tax.

Conveyance of real estate.—A tax of 50 cents for each $500 in value or fraction thereof is imposed upon all conveyances of lands, tenements or other realty, when the value, exclusive of liens thereon, is $100 or more. No tax is imposed on any instrument or writing given to secure a debt. Leases of real estate are not taxable; neither are contracts for the sale of real estate, making provision for future delivery by deed.

On an instrument conveying real estate there should be attached a tax stamp of the face value corresponding with the amount representing the vendor's equity conveyed. Where an exchange of equal equities in real estate is made between two persons a stamp should be attached to each of the two deeds, corresponding with the amount of each equity exchanged. In determining the amount of incumbrance upon real estate being transferred, no consideration is to be given to new incumbrances placed upon same at the time of, or after, the sale. Only incumbrances which rest on the property before the sale and which are not removed by the sale are to be taken into consideration.

A deed issued to cover a gift of property to the Government, wherein the consideration named is "desire to promote public welfare and $1," or "$1 and other valuable considerations," is not taxable.

Custom-house entry.—Entry of any goods, wares or merchandise at any custom-house, either for consumption or warehousing, is taxable as follows: not exceeding $100 in value, 25 cents; exceeding $100 and not exceeding $500 in value, 50 cents; exceeding $500 in value, $1.

Entry for customs withdrawal.—The tax on an entry for the withdrawal of any goods or merchandise from customs bonded warehouse is 50 cents.

Passage tickets.—Passage tickets one way or round trip, for each passenger, sold or issued in the United States for passage by any vessel to a port or place not in the United States, Canada, or Mexico, are taxed as follows: if costing not exceeding $30, $1; costing more than $30 and not exceeding $60, $3; costing more than $60, $5. There is no tax on such tickets costing $10 or less. It will be noted that the stamp tax covers foreign passage tickets only. Passage tickets beween points in the United States are taxed under the Public Utilities tax.

Voting proxies.—Proxies for voting at any election for officers, or meeting for the transaction of business, of any incorporated company or association, except religious, educational, charitable, fraternal, or literary societies, or public cemeteries, are taxed at the rate of 10 cents for each proxy.

Power of attorney.—Powers of attorney granting authority to do or perform some act for or in behalf of the grantor, which authority is not otherwise vested in the grantee, are taxed 25 cents each.

There is no tax upon the power of attorney contained in a transfer by assignment, absolute or as collateral security, of an interest in a contract of insurance, if the power of attorney grants authority to do or perform only such acts for or in behalf of the assignor as are otherwise vested in the assignee.

But no stamps are required on any papers necessary to be used for the collection of claims from the United States or from any State for pensions, back pay, bounty, or for property lost in the military or naval service, or upon powers of attorney required in bankruptcy cases.

Playing cards.—A tax of five cents per pack is imposed, in addition to the tax previously imposed and which still

remains in effect, on playing cards manufactured or imported, and sold, or removed for sale after the passage of the Act. This additional stamp tax on playing cards became effective October 4, 1917, making the total tax 7 cents per pack.

This tax does not apply to such cards tax-paid prior to October 4 at the two-cent rate under the Act of Aug. 28, 1894, in the hands of jobbers and retail dealers, unless the packs have been broken and cards repacked, in which event the dealer would be subject to the manufacturer's tax.

Under authority of sections 1001 and 1006, providing for the collection of taxes of this class under regulations prescribed by the Commissioner of Internal Revenue and for the use of stamps on hand at the passage of the Act, the following regulations are promulgated by the Treasury Department:

"Every manufacturer and importer of playing cards will render to the collector of the district wherein the factory is located, a sworn inventory in duplicate on or before October 31, 1917, showing separately the number of stamped and unstamped packs on hand at the beginning of business October 4th, and likewise the number of attached and unattached stamps at the rate of two cents. These inventories may be rendered on Form 215, modified to suit the nature of the article, or in typewritten form.

"On October 31, or within ten days thereafter, a return under oath in duplicate must be rendered, covering the period October 4 to 31 inclusive, showing the number of packs of cards manufactured or imported, the number withdrawn tax-paid, the name and address of each person, firm or corporation to whom such cards may be consigned or sold, the number and total value at the rate of two cents of stamps affixed, and the additional tax of five cents per pack due thereon.

"This return will be rendered for each subsequent

month on the last day thereof, or on or before the tenth day of the succeeding month, until the supply of stamps at the old rate on hand is exhausted.

"Forms for rendering these returns may be obtained upon application to the collector of the district; or manufacturers or importers, if they so desire, may make up such monthly return upon the typewriter, provided, it conforms in detail with that prescribed.

"Collectors will carefully verify these inventories and returns and enter for assessment the additional tax at 5 cents shown due from manufacturers or importers until the stock of stamps, at the rate of two cents, held by the tax payer is exhausted. Thereafter every manufacturer and importer will be required to render such return for each month during continuance in business, but the additional tax will not be noted thereon, as all stamps purchased from the collector on and after October 4 will be sold and accounted for at the new rate.

"On and after October 4 the collectors selling stamps on hand of the rate of two cents will overprint same, require payment and account therefor at the rate of seven cents per pack."

Parcel post packages.—Parcel post packages on which the postage amounts to 25 cents or more are taxed at the rate of 1 cent for each 25 cents or fractional part thereof charged for transportation. The tax is based on transportation charges alone, so that C. O. D. or insurance charges are not to be reckoned in computing the tax. The stamp must be affixed by the sender and canceled by him before the package is mailed, care being taken not to cancel the postage stamps. The stamps for tax payment must be revenue stamps and not extra postage stamps. Packages upon which the tax has not been so paid will not be transported.

The tax must be paid on parcel post packages mailed from one point in the United States to another, but pack-

ages sent to foreign countries, including Porto Rico, are not taxable.

For tax on express packages, see page 581.

Redemption of unused stamps.—Claim for allowance for or redemption of unused stamps may be made by the bona fide owner thereof or by his agent, who must set forth under oath, on Form 46, the facts relied on in support of his claim. The claim should be supported by the certificate of the deputy collector who personally has investigated the statements made by the claimant, and by the certificate of the collector for whom the stamps were purchased, giving such information as the Commissioner of Internal Revenue may desire. Upon allowance of the claim by the Commissioner the claim will be certified by him to the Auditor for the Treasury Department, who, in the absence of fraud or miscalculation, will certify the amount allowed to the Division of Bookkeeping and Warrants.

Redemption of stamps affixed to documents or articles.—In cases where stamps have been affixed to documents or articles not requiring them and canceled, or where, by error, stamps of greater value than necessary have been used, the procedure is substantially the same as in the case above. The stamps should be returned with the claim and where practicable, accompanied by the instruments to which the stamps have been attached, or certified copies thereof. If the instrument cannot be sent the collector may instruct his deputy to visit claimant's place of business, examine the instrument and cancel the stamps by writing across them the words "claim for refund filed."

Method of payment.—Adhesive stamps for the payment of these taxes may be purchased from collectors of the various districts and at post offices and banks designated as United States depositaries. Stamps have so far been issued in various denominations up to $2, but it is in-

tended later to issue denominations as high as $1,000, for Stock Exchange transactions.

Stamps denoting the amount of the tax must be affixed and canceled by writing or stamping upon them the initials of the person or concern using or affixing them, together with the date when so affixed. Stamps of the value of 10 cents or more should also be mutilated by making three parallel incisions lengthwise with a sharp instrument; proper perforations are permissible in lieu of the incisions.

Original documents only need to be stamped; copies should merely bear a statement to the effect that stamps are attached to the original.

Penalties.—The penalties provided for not complying with the stamp provisions are as follows:

"That whoever makes, signs, issues, or accepts, or causes to be made, signed, issued, or accepted, any instrument, document, or paper of any kind or description whatever, without the full amount of tax thereon being duly paid; consigns or ships, or causes to be consigned or shipped, by parcel post, any parcel, package, or article without the full amount of tax being duly paid; makes use of any adhesive stamp to denote any tax imposed by law without canceling or obliterating such stamp as prescribed, is guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not less than $100 for each offence."

It will be noted that the foregoing penalties apply equally to the maker and to the acceptor of any document upon which the tax has not been paid.

The penalty for fraudulent use of stamps, which includes the fraudulent removal of stamps from documents, etc., the use of previously canceled stamps or having in possession renovated stamps previously used, is a fine of not over $1,000 or imprisonment for not more than five years, together with forfeiture to the United States of the article upon which the stamp was used.

CHAPTER XXVI

WAR STAMP TAXES LAW

BEING TITLE VIII OF "AN ACT TO PROVIDE REVENUE TO DEFRAY WAR EXPENSES, AND FOR OTHER PURPOSES," APPROVED OCTOBER 3, 1917. (PUBLIC—No. 50—65th CONGRESS.) IN EFFECT OCTOBER 4, 1917, UNLESS OTHERWISE SPECIALLY PROVIDED

TITLE VIII.—WAR STAMP TAXES
Effective Dec. 1, 1917

Stamp taxes on bonds, certificates of stock, and other documents.—Sec. 800 [of the general revenue Act of which this Title is a part]. That on and after the first day of December, nineteen hundred and seventeen, there shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in Schedule A of this title, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, by any person, corporation, partnership, or association who makes, signs, issues, sells, removes, consigns, or ships the same, or for whose use or benefit the same are made, signed, issued, sold, removed, consigned, or shipped, the several taxes specified in such schedule.

No tax on bonds or other instruments of U. S., State, Municipal, or Foreign Governments.—Sec. 801. That there

shall not be taxed under this title any bond, note, or other instrument, issued by the United States, or by any foreign Government, or by any State, Territory, or the District of Columbia, or local subdivision thereof, or municipal or other corporation exercising the taxing power, when issued in the exercise of a strictly governmental, taxing, or municipal function; or stocks and bonds issued by co-operative building and loan associations which are organized and operated exclusively for the benefit of their members and make loans only to their shareholders, or by mutual ditch or irrigating companies.

Penalty for failure to pay tax, affix or cancel stamps.—Sec. 802. That whoever—

(*a*) Makes, signs, issues, or accepts, or causes to be made, signed, issued, or accepted, any instrument, document or paper of any kind or description whatsoever without the full amount of tax thereon being duly paid.

(*b*) Consigns or ships, or causes to be consigned or shipped, by parcel post any parcel, package, or article without the full amount of tax being duly paid:

(*c*) Manufactures or imports and sells, or offers for sale, or causes to be manufactured or imported and sold, or offered for sale, any playing cards, package, or other article without the full amount of tax being duly paid;

(*d*) Makes use of an adhesive stamp to denote any tax imposed by this title without cancelling or obliterating such stamp as prescribed in section eight hundred and four;

Is guilty of a misdemeanor and upon conviction thereof shall pay a fine of not more than $100 for each offense.

Penalty for fraudulently using stamps.—Sec. 803. That whoever—

(*a*) Fraudulently cuts, tears, or removes from any vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title,

any adhesive stamp or the impression of any stamp, die, plate, or other article provided, made, or used in pursuance of this title;

(*b*) Fraudulently uses, joins, fixes, or places to, with, or upon any vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title, (1) any adhesive stamp, or the impression of any stamp, die, plate, or other article, which has been cut, torn, or removed from any other vellum, parchment, paper, instrument writing, package, or article, upon which any tax is imposed by this title; or (2) any adhesive stamp or the impression of any stamp, die, plate, or other article of insufficient value; or (3) any forged or counterfeit stamp, or the impression of any forged or counterfeited stamp, die, plate, or other article;

(*c*) Willfully removes, or alters the cancellation, or defacing marks of, or otherwise prepares, any adhesive stamp, with intent to use, or cause the same to be used, after it has been already used, or knowingly or willfully buys, sells, offers for sale or gives away, any such washed or restored stamp to any person for use, or knowingly uses the same;

(*d*) Knowingly and without lawful excuse (the burden of proof of such excuse being on the accused) has in possession any washed, restored, or altered stamp, which has been removed from any vellum, parchment, paper, instrument, writing, package, or article, is guilty of a misdemeanor, and upon conviction shall be punished by a fine of not more than $1,000, or by imprisonment for not more than five years, or both, in the discretion of the court, and any such reused, canceled, or counterfeit stamp and the vellum, parchment, document, paper, package, or article upon which it is placed or impressed shall be forfeited to the United States.

Method of cancelling stamps.—Sec. 804. That whenever an adhesive stamp is used for denoting any tax imposed by this title, except as hereinafter provided, the person

corporation, partnership, or association, using or affixing the same shall write or stamp or cause to be written or stamped thereupon the initials of his or its name and the date upon which the same is attached or used, so that the same may not again be used: *Provided,* That the Commissioner of Internal Revenue may prescribe such other method for the cancellation of such stamps as he may deem expedient.

Methods of preparing, distributing and affixing stamps.—Sec. 805. (*a*) That the Commissioner of Internal Revenue shall cause to be prepared and distributed for the payment of the taxes prescribed in this title suitable stamps denoting the tax on the document, articles, or thing to which the same may be affixed, and shall prescribe such method for the affixing of said stamps in substitution for or in addition to the method provided in this title, as he may deem expedient.

(*b*) The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is authorized to procure any of the stamps provided for in this title by contract whenever such stamps can not be speedily prepared by the Bureau of Engraving and Printing; but this authority shall expire on the first day of January, nineteen hundred and eighteen, except as to imprinted stamps furnished under contract, authorized by the Commissioner of Internal Revenue.

(*c*) All internal-revenue laws relating to the assessment and collection of taxes are hereby extended to and made a part of this title, so far as applicable, for the purpose of collecting stamp taxes omitted through mistake or fraud from any instrument, document, paper, writing, parcel, package, or article named herein.

Sale of stamps by Post-offices.—Sec. 806. That the Commissioner of Internal Revenue shall furnish to the Postmaster General without prepayment a suitable quantity of adhesive stamps to be distributed to and kept on sale by the various postmasters in the United States. The

Postmaster General may require each such postmaster to give additional or increased bond as postmaster for the value of the stamps so furnished, and each such postmaster shall deposit the receipts from the sale of such stamps to the credit of and render accounts to the Postmaster General at such times and in such form as he may by regulations prescribe. The Postmaster General shall at least once monthly transfer all collections from this source to the Treasury as internal-revenue collections.

Sale of stamps by United States depositaries.—Sec. 807. That the collectors of the several districts shall furnish without prepayment to any assistant treasurer or designated depositary of the United States located in their respective collection districts a suitable quantity of adhesive stamps for sale. In such cases the collector may require a bond, with sufficient sureties, to an amount equal to the value of the adhesive stamps so furnished, conditioned for the faithful return, whenever so required of all quantities or amounts undisposed of, and for the payment monthly of all quantities or amounts sold or not remaining on hand. The Secretary of the Treasury may from time to time make such regulations as he may find necessary to insure the safe-keeping or prevent the illegal use of all such adhesive stamps.

SCHEDULE A.—STAMP TAXES.

Tax on bonds, debentures and certificates of indebtedness. —1. Bonds of indebtedness: Bonds, debentures, or certificates of indebtedness issued on and after the first day of December, nineteen hundred and seventeen, by any person, corporation, partnership, or association, on each $100 of face value or fraction thereof, 5 cents: *Provided*, That every renewal of the foregoing shall be taxed as a new issue; *Provided further*, That when a bond conditioned for the repayment or payment of

money is given in a penal sum greater than the debt secured, the tax shall be based upon the amount secured.

Tax on surety bonds.—2. Bonds, indemnity and surety: Bonds for indemnifying any person, corporation, partnership, or corporation who shall have become bound or engaged as surety, and all bonds for the due execution or performance of any contract, obligation, or requirement, or the duties of any office or position, and to account for money received by virtue thereof, and all other bonds of any description, except such as may be required in legal proceedings, not otherwise provided for in this schedule, 50 cents: *Provided,* That where a premium is charged for the execution of such bonds the tax shall be paid at the rate of one per centum on each dollar or fractional part thereof of the premium charged: *Provided further,* That policies of reinsurance shall be exempt from the tax imposed by this subdivision.

Tax on original issues of capital stock—3. Capital stock, issue: On each original issue, whether on organization or reorganization, of certificates of stock by any association, company, or corporation, on each $100 of face value or fraction thereof, 5 cents: *Provided,* That where capital stock is issued without face value, the tax shall be 5 cents per share, unless the actual value is in excess of $100 per share, in which case the tax shall be 5 cents on each $100 of actual value or fraction thereof.

The stamps representing the tax imposed by this subdivision shall be attached to the stock books and not to the certificates issued.

Tax on sales or transfers of stock.—4. Capital stock, sales or transfers: On all sales, or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to shares or certificates of stock in any association, company, or corporation, whether made upon or shown by the books of the association, company, or corporation, or by any assignment in blank, or by any delivery, or by any paper or agreement or memorandum

or other evidence of transfer or sale, whether entitling the holder in any manner to the benefit of such stock or not, on each $100 of face value or fraction thereof, 2 cents, and where such shares of stock are without par value, the tax shall be 2 cents on the transfer or sale or agreement to sell on each share, unless the actual value thereof is in excess of $100 per share, in which case the tax shall be 2 cents on each $100 of actual value or fraction thereof: *Provided,* That it is not intended by this title to impose a tax upon an agreement evidencing a deposit of stock certificates as collateral security for money loaned thereon, which stock certificates are not actually sold, nor upon such stock certificates so deposited: *Provided further,* That the tax shall not be imposed upon deliveries or transfers to a broker for sale, nor upon deliveries or transfers by a broker to a customer for whom and upon whose order he has purchased same, but such deliveries or transfers shall be accompanied by a certificate setting forth the facts: *Provided further,* That in case of sale where the evidence of transfer is shown only by the books of the company the stamp shall be placed upon such books; and where the change of ownership is by transfer of the certificate the stamp shall be placed upon the certificate; and in cases of an agreement to sell or where the transfer is by delivery of the certificate assigned in blank there shall be made and delivered by the seller to the buyer a bill or memorandum of such sale, to which the stamp shall be affixed; and every bill or memorandum of sale or agreement to sell before mentioned shall show the date thereof, the name of the seller, the amount of the sale, and the matter or thing to which it refers. Any person or persons liable to pay the tax as herein provided, or anyone who acts in the matter as agent or broker for such person or persons who shall make any such sale, or who shall in pursuance of any such sale deliver any stock or evidence of the sale of any stock

or bill or memorandum thereof, as herein required, without having the proper stamps affixed thereto with intent to evade the foregoing provisions shall be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not exceeding $1,000, or be imprisoned not more than six months, or both, at the discretion of the court.

Tax on sales of produce on exchanges.—5. Produce, sales of, on exchange: Upon each sale, agreement of sale, or agreement to sell, including so-called transferred or scratch sales, any products or merchandise at any exchange, or board of trade, or other similar place, for future delivery, for each $100 in value of the merchandise covered by said sale or agreement of sale or agreement to sell, 2 cents, and for each additional $100 or fractional part thereof in excess of $100, 2 cents: *Provided,* That on every sale or agreement of sale or agreement to sell as aforesaid there shall be made and delivered by the seller to the buyer a bill, memorandum, agreement, or other evidence of such sale, agreement of sale, or agreement to sell, to which there shall be affixed a lawful stamp or stamps in value equal to the amount of the tax on such sale: *Provided further,* That sellers of commodities described herein, having paid the tax provided by this subdivision, may transfer such contracts to a clearing house corporation or association, and such transfer shall not be deemed to be a sale, or agreement of sale, or an agreement to sell within the provisions of this Act, provided that such transfer shall not vest any beneficial interest in such clearing house association but shall be made for the sole purpose of enabling such clearing house association to adjust and balance the accounts of the members of said clearing house association on their several contracts. And every such bill, memorandum, or other evidence of sale or agreement to sell shall show the date thereof, the name of the seller, the amount of the sale, and the matter or

thing to which it refers; and any person or persons liable to pay the tax as herein provided, or anyone who acts in the matter as agent or broker for such person or persons, who shall make any such sale or agreement of sale, or agreement to sell, or who shall, in pursuance of any such sale, agreement of sale, or agreement to sell, deliver any such products or merchandise without a bill, memorandum, or other evidence thereof as herein required, or who shall deliver such bill, memorandum, or other evidence of sale, or agreement to sell, without having the proper stamps affixed thereto, with intent to evade the foregoing provisions, shall be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not exceeding $1,000, or be imprisoned not more than six months, or both, at the discretion of the court.

That no bill, memorandum, agreement, or other evidence of such sale, or agreement of sale, or agreement to sell, in case of cash sales of products or merchandise for immediate or prompt delivery which in good faith are actually intended to be delivered shall be subject to this tax.

Tax on drafts, promissory notes and post-dated checks.— 6. Drafts or checks payable otherwise than at sight or on demand, promissory notes, except bank notes issued for circulation, and for each renewal of the same, for a sum not exceeding $100, 2 cents; and for each additional $100 or fractional part thereof, 2 cents.

Tax on deeds and other instruments of conveyance.—7. Conveyance: Deed, instrument, or writing, whereby any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers, or any other person or persons, by his, her, or their direction, when the consideration or value of the interest or property conveyed, exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, exceeds $100 and does not exceed $500, 50 cents; and for each

additional $500 or fractional part thereof 50 cents: *Provided,* That nothing contained in this paragraph shall be so construed as to impose a tax upon any instrument or writing given to secure a debt.

Tax on custom-house entries.—8. Entry of any goods, wares, or merchandise at any custom-house, either for consumption or warehousing, not exceeding $100 in value, 25 cents; exceeding $100 and not exceeding $500 in value, 50 cents; exceeding $500 in value, $1.

Tax on withdrawals from bonded warehouse.—9. Entry for the withdrawal of any goods or merchandise from customs bonded warehouse, 50 cents.

Tax on passage tickets.—10. Passage ticket, one way or round trip, for each passenger, sold or issued in the United States for passage by any vessel to a port or place not in the United States, Canada, or Mexico, if costing not exceeding $30, $1; costing more than $30 and not exceeding $60, $3; costing more than $60, $5:

Provided, That such passage tickets, costing $10 or less, shall be exempt from taxation.

Tax on proxies.—11. Proxy for voting at any election for officers, or meeting for the transaction of business, of any incorporated company or association, except religious, educational, charitable, fraternal, or literary societies, or public cemeteries, 10 cents.

Tax on powers of attorney.—Power of attorney granting authority to do or perform some act for or in behalf of the grantor, which authority is not otherwise vested in the grantee, 25 cents: *Provided,* That no stamps shall be required upon any papers necessary to be used for the collection of claims from the United States or from any State for pensions, back pay, bounty, or for property lost in the military or naval service or upon powers of attorney required in bankruptcy cases.

Tax on playing cards.—13. Playing cards: Upon every pack of playing cards containing not more than fifty-four cards, manufactured or imported, and sold, or re-

moved for consumption, or sale, after the passage of this Act, a tax of 5 cents per pack in addition to the tax imposed under existing law.[1]

Tax upon parcel-post packages.—14. Parcel-post packages: Upon every parcel or package transported from one point in the United States to another by parcel-post on which the postage amounts to 25 cents or more, a tax of 1 cent for each 25 cents or fractional part thereof charged for such transportation, to be paid by the consignor.

No such parcel or package shall be transported until a stamp or stamps representing the tax due shall have been affixed thereto.

Approved by the President, October 3, 1917.

[1] This tax is two cents upon every pack.

CHAPTER XXVII

WAR TAX ON PUBLIC UTILITIES AND INSURANCE

What is taxed.—Sections 500 to 505, Title V, of the Act of October 3, 1917, provide for a tax on and after November 1, 1917, upon payments made for domestic freight, express and passenger transportation; transportation of oil by pipe line; telegraph, telephone and radio messages; life insurance; marine, inland and fire insurance, and other insurance policies.

Transportation defined.—The definition of "transportation" in its relation to the business of common carriers contained in the Interstate Commerce Act of June 29, 1906 (34 Stat. 584), is held to apply to that term as used in section 500 of the Act of October 3, 1917, and is as follows:

"The term transportation shall include cars and other vehicles and all instrumentalities and facilities of shipment or carriage, irrespective of ownership or of any contract express or implied, for the use thereof and all services in connection with the receipt, delivery, elevation, and transfer in transit, ventilation, refrigeration or icing, storage and handling of property transported."

Who pays the tax.—The tax, in the case of the various charges for transportation and messages, is added to the regular charges and is paid by the public. In the case of insurance, the tax is intended to be borne by the insurance companies and not added to the amount of the premiums.

While, in the case of the tax on transportation, the person or company rendering the service is charged with the duty of collecting the tax and making proper returns and payment to the collector, in a Treasury decision of December 1, 1917, it is held that passengers purchasing tickets, if they neglect to pay the tax, are liable to the penalties, as well as the carriers. The penalty provided is a fine of not over $1,000 or imprisonment for not exceeding one year. This decision was made necessary by the laxity as to payment, in the early period of the incidence of the tax.

Exemptions relating to transportation and messages.—It is provided in section 502 "that no tax shall be imposed under section five hundred upon any payment received for services rendered to the United States, or any State, territory, or the District of Columbia. The right to exemption under this section shall be evidenced in such manner as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe."

The foregoing is held to apply also to political subdivisions of States and Territories. Specific exemptions include all institutions maintained solely for the exercise of legitimate governmental functions, such as State colleges, public libraries, hospitals, etc.

The Food Administration Grain Corporation, Federal Farm Loan Board, Federal land banks, farm loan registers, land bank examiners, and land bank appraisers are exempt from tax under this section, when exercising strictly governmental functions.

Decisions of the Treasury Department with regard to specific conditions will be quoted or referred to under the sections below, relating to freight, express and passenger transportation.

Definitions relating to transportation.—The term "United States," as used in section 500 in the phrase "from one point in the United States to another," means the

States, Territories of Alaska and Hawaii, and the District of Columbia.

The phrase "for less than 30 miles" means for less than 30 constructive miles in instances where two or more carriers are competing for transportation services.

"Commutation or season tickets" include all tickets issued to and intended for the use of the purchaser for a certain number of trips between two given termini, whether limited or unlimited as to the time in which they are to be used. Commutation or season tickets do not include party tickets.

Freight.—The tax on freight charges, paid by shippers, is 3 per cent of the amount paid for the transportation by rail or water or by any form of mechanical motor power when in competition with carriers by rail or water of property by freight consigned from one point in the United States to another. Ferry charges are included.

Carriers transporting their own commodities, except such commodities as are necessary for use in their business as carriers, are required to pay a tax equal to that which would have accrued if the service had been paid for. No tax accrues, however, for transportation by a carrier of a commodity necessary and intended to be used in the conduct of its business as such; neither is any tax imposed in a case where such a commodity is transported for the similar use of another carrier which is a part of the same "system."

Government exemptions.—The following are Treasury decisions relating to cases in which transportation is for services rendered to the Government:

All shipments either by freight or express, the charges on which are paid directly by the United States, will be free of the tax imposed by section 500. Shipments of Government property by Government officers will be made on Government bills of lading.

Shipments of property belonging to a State, Terri-

tory, or the District of Columbia, the charges on which are paid by the State, Territory or the District of Columbia, will be made free of the tax imposed by section 500. The words "State" and "Territory" are held to include the political subdivisions thereof.

It will be necessary in all cases of shipments made by freight or express, where Government bills of lading are not used, for the officer or employee of the United States, State, Territory, or the District of Columbia, to satisfy the agent to whom the charges are paid that the service rendered or to be rendered is for the United States, State, Territory, or the District of Columbia, as the case may be, and the agent collecting the charges should note on the records of his office the name of the consignor and consignee, and indicate thereon that such shipment covered service rendered the United States, State, Territory, or the District of Columbia, as the case may be, and was not subject to the tax.

Shipments by freight or express of property received by the United States, or any State, Territory, or the District of Columbia, are free of the transportation tax, provided the United States or any State, Territory, or the District of Columbia is liable for and pays the transportation charges on such shipments.

Miscellaneous Treasury decisions. — In all cases in which shippers have credit arrangements with carriers under which their goods are shipped prepaid but the freight charges were not actually paid until after November 1, 1917, the tax is not imposed on amounts paid for such transportation begun prior to November 1, 1917.

If the consignees have credit arrangements with carriers under which they settle their freight bills on or before the 15th of the month, the tax is not imposed or charged on freight bills for the transportation of goods actually delivered prior to November 1, 1917.

No tax is imposed upon amounts paid for transporta-

tion of goods by freight in any instance in which the property was actually delivered to the consignee prior to November 1, 1917, and by reason of the loss of the bill of lading, dispute as to the amount of charges, or other delay, the payment was not made at the time of delivery.

No tax is imposed on the amount paid for transportation on a through bill of lading to or from Canada or Mexico or any foreign country. If however, property is shipped by freight from a point in the United States to a seaport on one bill of lading and is then reconsigned for export, the tax is imposed on the amount paid for the transportation to the seaport.

Goods which are imported into the United States and reconsigned at port of entry to a point in the United States are subject to the tax upon the amount paid for transportation from the port of entry to destination in the United States. If the property is consigned from a foreign port to a point within the United States without being reconsigned at the port of entry, the tax is not to be imposed.

A railroad transporting a circus train should apportion the charges for the service rendered between the freight and passenger service, and the tax imposed by subdivision (a) of section 500 should be collected in the case of the former, and the 8 per cent tax imposed by subdivision (c) of said section should be collected in the case of the latter.

Where the charge for transportation includes the charge for lighterage, which service is performed on or after November 1, 1917, the tax collected on or after that date should be based upon the entire charge for transportation.

Logging companies which do a carrier business are subject to the tax imposed by section 500 upon the transportation of commodities owned by them which are not necessary for their use in the conduct of their

business as carriers and are not intended to be so used or have not been so used.

Where a railroad company carries materials for a telegraph company free in consideration of messages sent free over the lines of the telegraph company, the tax attaches upon the amounts which the railroad company and the telegraph company would otherwise receive for services performed but for the comity of relations between them.

Tax attaches upon the amount paid for transportation of goods from one pier to another in the same harbor.

Tax does not attach separately on the following miscellaneous services rendered by a carrier when the charge for such services is included and paid in the through tariff rate for the road haul: (a) switching and drayage; (b) wharfage, storage and lighterage; (c) compressing in transit; (d) milling in transit; (e) dressing and refining in transit; (f) diversion and reconsigning charges; (g) refrigeration; (h) car service; (i) demurrage; (j) charge for consigning freight to order notify; (k) storage; (l) car rental; (m) switch charges for return of empty cars over belt or switching lines; (n) weighing charges; (o) feeding and watering stock in transit.

However, if the through tariff rate does not include such services, the amounts paid for the same are taxable if such services are a part of the transportation by the carrier.

In instances in which the amount paid for transportation by freight is a lump sum the tax should be imposed upon such sum without regard to the individual items which make up the total. In computing the tax, a fraction of a cent should be disregarded unless it amounts to one half cent or more, in which case it should be increased to 1 cent.

When property is transported part of the way by

freight and part of the way by express the tax will be 3 per cent on the amount paid for the freight movement and 1 cent for each 20 cents or fraction paid for the movement by express.

Express.—The tax on express charges is "1 cent for each 20 cents or fraction thereof paid to any person, corporation, partnership or association, engaged in the business of transporting parcels or packages by express over regular routes between fixed terminals, for the transportation of any package, parcel or shipment by express from one point within the United States to another."

The tax is to be paid by the shipper.

Exemptions.—The exemptions in favor of the Government and States set forth above under "Freight" apply also to shipments by express.

Separate items of a shipment need not be listed.—The question as to whether or not under paragraph (b), section 500, newspapers or similar articles shipped by express shall be accounted for for taxing purposes in separate packages or in bulk shipments is answered in the following Treasury decision:

From the facts presented it appears that the method of transporting newspapers by express is to deliver to the express company in bulk, tied or fastened together, an entire shipment, and to base and pay the express charges thereon without regard to enclosed subdivisions to be thrown off or delivered at way stations; that is to say: if 500 pounds of newspapers should be shipped on a single car at one time, to be distributed at 10 different stations, the package would be received as one shipment and the total express charge would be for the aggregate amounts of the 10 subdivisions, and not upon the basis of the 10 deliveries.

As this was a fact and a commercial condition at the time of the passage of the Act, Congress is assumed, if the contrary does not otherwise appear in the law, to have enacted the taxing provision relative to express shipments in view of and to meet such existing commercial conditions and practice.

It will be observed that the tax is laid upon the transportation of "any package, parcel, or shipment by express from one point in the United States to another."

These shipments, as indicated in the above example, would be from one point to 10 different points, and a literal interpretation of the law, taken

in connection with the use of the words "package, parcel or shipment," might require the payment of this tax upon the parcel, or separate delivery basis.

This seems to have been in the mind of Congress at the time of the enactment of the law, but the proviso immediately following was doubtless intended to cure the difficulties or delays that might arise out of the literal interpretation of the language used. That proviso reads as follows:

Provided: That nothing herein contained shall be construed to require the carrier collecting such tax to list separately in any bill of lading, freight receipt, or similar document, the amount of the tax herein levied, if the total amount of the freight and tax be therein stated.

It is manifest from the foregoing that it will not be necessary to specify in each express receipt the separate parcels marked with the name of the point of delivery or to pay the tax upon that basis, if the total amount paid for transportation of the entire shipment and the tax due and paid be stated in such receipt.

All transportation of milk and cream by express companies is "by express" and is taxable as such. If transportation is by trolley line the classification employed by the trolley line as "by freight" or "by express" will govern, and the tax will be imposed accordingly.

Charges for delivery of packages by horse-drawn vehicles will not be included in the taxable express charges, since the tax applies only to transportation by mechanical motor power.

Passenger transportation.—The tax on passenger transportation is 8 per cent of the fare (except where fare is 35 cents or less or where season or commutation tickets are used for trips of less than 30 miles), payable by the passenger, although the tax return and actual payment to the collector is made by the carrier. The transportation so taxable is, as in the case of freight and express transportation, that which is over a regularly established line, rail or by water, in competition with other carriers. Automobile carriers operating on a regularly established route are included in cases where the fare is over 35 cents.

The tax attaches in each case where the distance traveled in a continuous journey is 30 miles or more, or where the total fare is 35 cents or more. Round-trip

tickets costing 70 cents or more are taxable. The tax is to be collected pro rata in cases where the fare is collected in amounts of less than 35 cents, as sometimes happens in the "zone" system. The tax is collectible notwithstanding the passenger may pay cash for part of the transportation and give commutation tickets for another part.

In the case of passenger transportation, the tax applies not only to points within the United States, but also to transportation to Canada or Mexico, if the tickets therefor are sold and issued in the United States.

Pullman berths, staterooms, etc.—There is also a tax of 10 per cent for seats, berths, and staterooms in parlor cars, sleeping cars, or on vessels. Where the price of the ticket includes charges for berth, stateroom and meals, which cannot be segregated, a tax of only 8 per cent of the amount paid for the ticket is collectible.

Exemptions.—Exemptions in favor of the Government are described in the Treasury decisions given below:

When officers or employees of the United States, or of any State, Territory, or the District of Columbia, travel on transportation requests, the transportation requests will be sufficient evidence that the tickets obtained thereon either for transportation by rail or water, or for seats, berths, or staterooms in parlor cars, sleeping cars or on vessels, were received from the agent without the payment of tax imposed by section 500.

The agent of the transportation company who issues the ticket should note on the records of his office the number of the Government transportation request. Where travel is made by officers or employees of a State, Territory, or the District of Columbia, upon transportation requests, a notation should be made on the records of the agent issuing the ticket so that a verification can be made, as in case of Government transportation requests.

When an officer or employee of the United States, or of a State, Territory, or the District of Columbia, is traveling on official business and pays cash for his transportation, or presents a mileage book purchased prior to November 1, 1917, he will give to the agent from whom tickets are obtained for transportation by rail, or water, or vessels, or the conductor or agent to whom he presents the mileage book, his certificate stating that the service to be rendered from the place named is on account of official business and not for private purposes. Transportation agents should not accept such certificate unless the officer or employee presenting same shows satisfactory credentials.

In case a ticket, obtained either on a transportation request or by purchase and not partially used prior to November 1, 1917, is presented for travel on official business on or after November 1, 1917, a certificate made in the form indicated above should be given to the conductor to whom such ticket is first presented.

Commutation, season, and party tickets.—"Commutation or season tickets" include all tickets issued to and intended for the use of the purchaser for a certain number of trips between two given termini, whether limited or unlimited as to the time in which they are to be used; commutation or season tickets do not include party tickets. The tax must be paid on such tickets at the time of purchase, where the length of the specified journeys is 30 miles or more, or the fare for each journey is 35 cents or more.

Mileage books. — A mileage book purchased on or after November 1, 1917, is subject to tax upon the full purchase price at the time of purchase; where a mileage book purchased prior to November 1, 1917, is used on or after that date, the person presenting such book, whether the transportation fare to be used is more or less than 35 cents, must pay to the conductor or other agent the tax on such proportionate amount of the cost

of the book as the unused mileage bears to the total mileage originally in the book.

Baggage.—Amount paid for transportation of excess baggage is held to be part and parcel of the amount paid for transportation of persons and is therefore subject to tax at a like rate; no tax is imposed under the Act of October 3, 1917, on amounts paid for the storage of baggage.

Through transportation.—Where through transportation is paid in full, for example, from New York to Hongkong by way of Vancouver, British Columbia, the railway ticket from New York to Vancouver would be subject to tax under section 500, and the steamship ticket from Vancouver to Hongkong would be subject to the tax imposed on passage tickets.

A through ticket purchased in Hongkong for Habana, Cuba, routed trans-Pacific steamer to San Francisco, rail lines thence to New Orleans, and steamship line thence to Habana, the ticket containing an order "Good for exchange in San Francisco for a railroad ticket from San Francisco to New Orleans, and in New Orleans for a steamship ticket from New Orleans to Habana," is subject to the tax imposed by subdivision (c) of section 500 on the amount paid for the transportation from San Francisco to New Orleans, and to the tax imposed by paragraph (10)[1] of Schedule A, Title VIII, of the Act of October 3, 1917, on amounts paid for transportation from New Oreans to Habana, Cuba.

Corpses.—Where a corpse is transported under tariffs requiring one first-class ticket therefor and one first-class ticket for an attendant, under the carrier's regulations, the tax is imposed as in the case of passenger transportation on both tickets; where a corpse is transported by freight or express, the amount paid for such transportation would be subject to the tax imposed in the case of freight or express transportation.

[1] Passage Tickets for Foreign Ports.

Telegraph, telephone and radio messages.—A tax of 5 cents for each such message is imposed, payable by the sender on each such message originating within the United States and for the transmission of which a charge of 15 cents or more is made.

Only one tax is imposed, notwithstanding the lines or stations of more than one concern be used for transmission.

Exemptions.—All telegraph, telephone or radio messages of officers and employees of the United States, or of a State, Territory, or the District of Columbia, or political subdivision thereof, on official business, are exempt from tax, and should not be reported in the monthly return of the telegraph, telephone or radio company. Such messages, conversations and dispatches, to be exempt, must not only relate to Government business but must be a charge against and actually be paid for out of Government funds. In case of a telegraph or radio message, the officer or employee sending such message should certify thereon that it is on account of official business and not for private purposes. This certificate may be in the following form:

"I certify that this message is on official business and not for private purposes.

"...........................

"...................(Title)."

Oil pipe-lines.—A tax of 5 per cent is imposed on all charges for transportation of oil by pipe-line.

Returns.—Returns on all the taxes mentioned above are required monthly in duplicate, as provided in section 503. The first return is due on or before February 28, 1918, covering the month of November, 1917. Returns for each month thereafter must be made and tax paid over on or before three months from the last day of the month covered by the return.

Penalties.—The penalty for failure to comply with the provisions of section 500 is a fine of not more than $1,000 or imprisonment for not more than one year, or both. The penalty is imposed not only upon the person or corporation required to make the return and pay over the tax, but also upon the person failing to pay the tax at the time he pays the transportation charges.

Insurance.—The taxes imposed upon the various forms of insurance effective November 1, 1917, are as follows, no policies of reinsurance [1] being taxable:

(a) *Life insurance.*—The tax imposed on life insurance policies is 8 cents on each $100 or fractional part thereof of the amount for which any life is insured under any form of policy, except policies issued by persons, corporations, partnerships or associations whose income is exempt from taxation under Title I of the Act of September 8, 1916.

Life insurance policies for an amount not in excess of $500 and issued on the industrial or weekly payment plan are taxed at the rate of 40 per cent of the amount of the first weekly premium.

The tax does not apply to Soldiers' and Sailors' Insurance written by the War Risk Bureau.

(b) *Marine, inland and fire insurance.*—The tax on policies of property insurance of any description (including rents and profits) made or renewed on or after November 1, 1917, is at the rate of 1 cent on every dollar or fractional part thereof of the premium charged.

(c) *Casualty insurance.*—The tax on casualty insurance policies is 1 cent on each dollar or fractional part thereof of the premium charged.

Companies insuring or guaranteeing any loss that might be occasioned by reason of accepting mortgages that cannot be foreclosed or in any manner recovered upon are subject to tax under paragraph (c).

[1] Reinsurance is the underwriting of part of the liability of one company by another company.

Associations composed of employers or others who band themselves together for mutual protection in issuing life and casualty insurance are subject to tax under paragraph (c) unless exempted from income tax under Title I of the Act of September 8, 1916, and as amended.

If mutual fire or tornado insurance companies are exempt under the income tax law, no tax is imposed by this Act. Said Income Tax Law is, in part, as follows:

"Farmers' or other mutual, hail, cyclone, or fire insurance company * * * or organization of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses."

Insurance policies issued by organizations of the above description are exempt.

Miscellaneous Treasury decisions.—Brokers who place risks for clients with insurance companies are not subject to tax under section 504 (War Tax on Insurance Policies), as the tax is imposed upon the companies issuing the insurance.

No tax on insurance is imposed on the insured. The tax is imposed by section 504 upon the person, firm, or corporation writing the insurance, the necessary returns for which will be rendered to the collector of the district in which the principal place of business is located. The tax is imposed on newly written policies and on premiums paid on "open" policies, but not on amounts paid on policies of reinsurance. Consequently, where an insurance company reinsures the risks of another company the transaction is termed reinsurance, and would not be taxable. The tax is imposed on insurance without regard to sex or age of the insured.

Reinsurance is regarded as that insurance taken out by a company which has overinsured and obtained another company to underwrite for it a part of the liability.

Tax accrues on insurance policies issued within the United States, irrespective of the residence of the insured.

Tax under section 504 is imposed on the premium charged, each separate premium collected being regarded as a separate item for the computation of the tax, and not on the gross amount of the premiums collected for any one month.

So far as the tax is concerned, the issuance of a policy is considered to be of the date when the policy is delivered to the insured or in any other manner becomes a valid claim and effective for insurance.

Returns.—Return for tax on insurance may be filed either direct from the home office, or by the State or district superintendent or agent, where such is appointed or employed. Such State or territorial agents should be given authority, in writing, from the main office, to make such returns and account for the tax due on policies written. Single reports, prepared by home offices, however, are preferred. Local insurance agents will not be required to make returns.

Blank forms of returns required by section 505 will be furnished to insurance companies monthly by the Commissioner of Internal Revenue.

Returns showing the name and address of each person to whom an indemnity is paid are not required.

Permission will be granted to take credit in a subsequent month's report for any overpayment of tax for a prior month.

The first return was due December 15, 1917, covering the month of November. Each return must be made on or before the 15th day of each month, covering all policies issued during the preceding month.

CHAPTER XXVIII

WAR TAX ON UTILITIES AND INSURANCE LAW

BEING TITLE V OF "AN ACT TO PROVIDE REVENUE TO DEFRAY WAR EXPENSES, AND FOR OTHER PURPOSES," APPROVED OCTOBER 3, 1917. (PUBLIC—No. 50—65th CONGRESS.) IN EFFECT OCTOBER 4, 1917, UNLESS OTHERWISE SPECIALLY PROVIDED.

TITLE V.—WAR TAX ON FACILITIES FURNISHED BY PUBLIC UTILITIES, AND INSURANCE.

Freight and express shipments, passenger traffic, etc.—Sec. 500 [of the general revenue Act of which this Title is a part]. That from and after the first day of November, nineteen hundred and seventeen, there shall be levied, assessed, collected, and paid (*a*) a tax equivalent to three per centum of the amount paid for the transportation by rail or water or by any form of mechanical motor power when in competition with carriers by rail or water of property by freight consigned from one point in the United States to another; (*b*) a tax of 1 cent for each 20 cents, or fraction thereof, paid to any person, corporation, partnership, or association, engaged in the business of transporting parcels or packages by express over regular routes between fixed terminals, for the transportation of any package, parcel, or shipment by express from one point in the United States

to another: *Provided,* That nothing herein contained shall be construed to require the carrier collecting such tax to list separately in any bill of lading, freight receipt, or other similar document, the amount of the tax herein levied, if the total amount of the freight and tax be therein stated; (*c*) a tax equivalent to eight per centum of the amount paid for the transportation of persons by rail or water, or by any form of mechanical motor power on a regular established line when in competition with carriers by rail or water, from one point in the United States to another or to any point in Canada or Mexico, where the ticket therefor is sold or issued in the United States, not including the amount paid for commutation or season tickets for trips less than thirty miles, or for transportation the fare for which does not exceed 35 cents, and a tax equivalent to ten per centum of the amount paid for seats, berths, and staterooms in parlor cars, sleeping cars, or on vessels. If a mileage book used for such transportation or accommodation has been purchased before this section takes effect, or if cash fare be paid, the tax imposed by this section shall be collected from the person presenting the mileage book, or paying the cash fare, by the conductor or other agent, when presented for such transportation or accommodation, and the amount so collected shall be paid to the United States in such manner and at such times as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe; if a ticket (other than a mileage book) is bought and partly used before this section goes into effect it shall not be taxed, but if bought but not so used before this section takes effect, it shall not be valid for passage until the tax has been paid and such payment evidenced on the ticket in such manner as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe; (*d*) a tax equivalent to five per centum of the amount paid for the

transportation of oil by pipe line; (*e*) a tax of 5 cents upon each telegraph, telephone, or radio, dispatch, message, or conversation, which originates within the United States, and for the transmission of which a charge of 15 cents or more is imposed: *Provided,* That only one payment of such tax shall be required, notwithstanding the lines or stations of one or more persons, corporations, partnerships, or associations shall be used for the transmission of such dispatch, message, or conversation.

Sec. 501. That the taxes imposed by section five hundred shall be paid by the person, corporation, partnership, or association paying for the services or facilities rendered.

In case such carrier does not, because of its ownership of the commodity transported, or for any other reason, receive the amount which as a carrier it would otherwise charge, such carrier shall pay a tax equivalent to the tax which would be imposed upon the transportation of such commodity if the carrier received payment for such transportation: *Provided,* That in case of a carrier which on May first, nineteen hundred and seventeen, had no rates or tariffs on file with the proper Federal or State authority, the tax shall be computed on the basis of the rates or tariffs of other carriers for like services as ascertained and determined by the Commissioner of Internal Revenue: *Provided further,* That nothing in this or the preceding section shall be construed as imposing a tax (*a*) upon the transportation of any commodity which is necessary for the use of the carrier in the conduct of its business as such and is intended to be so used or has been so used; or (*b*) upon the transportation of company material transported by one carrier, which constitutes a part of a railroad system, for another carrier which is also a part of the same system.

United States and States exempt from tax.—Sec. 502. That no tax shall be imposed under section five hundred

upon any payment received for services rendered to the United States, or any State, Territory, or the District of Columbia. The right to exemption under this section shall be evidenced in such manner as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe.

Tax returns and payment.—Sec. 503. That each person, corporation, partnership, or association receiving any payments referred to in section five hundred shall collect the amount of the tax, if any, imposed by such section from the person, corporation, partnership, or association making such payments, and shall make monthly returns under oath, in duplicate, and pay the taxes so collected and the taxes imposed upon it under paragraph two of section five hundred and one to the collector of internal revenue of the district in which the principal office or place of business is located. Such returns shall contain such information, and be made in such manner, as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe.

War tax on insurance policies.—Sec. 504. That from and after the first day of November, nineteen hundred and seventeen, there shall be levied, assessed, collected, and paid the following taxes on the issuance of insurance policies: (*a*) Life insurance: A tax equivalent to 8 cents on each $100 or fractional part thereof of the amount for which any life is insured under any policy of insurance, or other instrument, by whatever name the same is called: *Provided,* That on all policies for life insurance only by which a life is insured not in excess of $500, issued on the industrial or weekly payment plan of insurance, the tax shall be forty per centum of the amount of the first weekly premium: *Provided further,* That policies of reinsurance shall be exempt from the tax imposed by this subdivision; (*b*) Marine, inland, and fire insurance: A tax equivalent to 1 cent

on each dollar or fractional part thereof of the premium charged under each policy of insurance or other instrument by whatever name the same is called whereby insurance is made or renewed upon property of any description (including rents or profits), whether against peril by sea or inland waters, or by fire or lightning, or other peril: *Provided*, That policies of reinsurance shall be exempt from the tax imposed by this subdivision;

(*c*) Casualty insurance: A tax equivalent to 1 cent on each dollar or fractional part thereof of the premium charged under each policy of insurance or obligation of the nature of indemnity for loss, damage, or liability (except bonds taxable under subdivision two of Schedule A of Title VIII) issued or executed or renewed by any person, corporation, partnership, or association, transacting the business of employer's liability, workmen's compensation, accident, health, tornado, plate glass, steam boiler, elevator, burglary, automatic sprinkler, automobile, or other branch of insurance (except life insurance, and insurance described and taxed in the preceding subdivision): *Provided,* That policies of reinsurance shall be exempt from the tax imposed by this subdivision;

(*d*) Policies issued by any person, corporation, partnership, or association, whose income is exempt from Taxation under Title I of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, shall be exempt from the taxes imposed by this section.

Insurance tax returns and payment.—Sec. 505. That every person, corporation, partnership, or association, issuing policies of insurance upon the issuance of which a tax is imposed by section five hundred and four, shall, within the first fifteen days of each month, make a return under oath, in duplicate, and pay such tax to the collector of internal revenue of the district in which

the principal office or place of business of such person, corporation, partnership, or association is located. Such returns shall contain such information and be made in such manner as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe.

Approved by the President, October 3, 1917.

CHAPTER XXIX

WAR TAX ON ADMISSIONS AND DUES

What is taxed.—The war tax on admissions[1] and dues, effective on and after November 1, 1917, is a tax of 1 cent for each 10 cents or fraction thereof, and in some cases of 10 per cent, of charges made for admission to any place to which an admission charge is made for private or personal profit. Among the classes of admissions so taxable are those to theaters, cabarets, club memberships and athletic and racing associations. The tax payable in each case is specified below under the appropriate heading.

The tax being upon the privilege of admission, liability to tax upon any admission or dues depends, as has recently been decided by the Treasury Department, not upon the date of the payment, but upon the date of the admission or the period for which the dues are paid. Earlier rulings, no longer in effect, had imposed the tax, for example, also upon amounts paid for dues in arrears, if such amounts were actually received after the tax became effective.

The object of the tax, like that of the war excise tax, seems to be to collect a revenue from the nation's expenditures for what may be called "near-luxuries." It is at the other extreme in principle from the ancient expedient, not yet wholly abandoned in some parts of the world, of taxing absolute necessities, such as salt. It will be seen that few, if any, of the admissions and

[1] The term "admission" includes seats and tables, reserved or otherwise, and other similar accommodations, and the charges made therefor.

dues taxable are other than those that represent the price the public is willing to pay for amusements or social exclusiveness, neither of which are absolutely necessary for the maintaining of life, however helpful they may be in maintaining the life to which the public has become accustomed.

Exemptions.—General exemptions from the tax are as follows:

(1) Admission to a place the maximum charge for admission to which is 5 cents, or to shows, rides and other amusements (the maximum charge for admission to which is 10 cents) within outdoor general amusement parks, or to such outdoor general amusement parks.

(2) Admissions, all the proceeds [1] of which inure exclusively to the benefit of religious, educational, or charitable institutions, societies, or organizations [2] or admissions to agricultural fairs none of the profits of which are distributed to stockholders or members of the association conducting the same.

(3) Amounts paid as dues or fees to a fraternal beneficiary society, order, or association operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order or association, or their dependents.

Specific cases concerning exemptions passed on by the Treasury Department include the following:

Dues charged by the Y. M. C. A. and the Y. M. H. A. are exempt.

Complimentary tickets issued to benefit concerts or entertainments for a charity hospital or for other similar institutions, the proceeds of which are exempt

[1] The word "proceeds" is held to mean gross receipts less payments of proper expenses; or, in other words, "net proceeds."

[2] To be a religious, educational, or charitable institution, society or organization, such purposes must be its primary or principal function.

tax is computed on the basis of the price paid for similar boxes at single performances by parties who pay for each performance severally. The tax may be computed, if there are no other boxes of similar size, by taking as a basis the price charged for a single seat in smaller or larger bôxes, or if there are no other boxes, the price of a single seat in the same part of the house, and multiplying this price by the number of seats in the box in question.

In the case of admission by season ticket or subscription, the amount of the tax is equivalent to 1 cent for each 10 cents of the proportion of the amount paid for such season or subscription covering admissions on or after November 1, 1917.

On and after December 15th no person may be admitted to any place to which admission is charged unless the ticket, card or pass by which he is admitted bears evidence that the tax due in respect of the admission covered by it has been paid. This evidence must consist of the printing or stamping upon the ticket, card, pass or other papers evidencing the right to admission the words "tax paid." Each proprietor of any place to which admission is charged not specifically exempted from taxation by the Act must provide himself with such a stamp as may be necessary for this purpose. Such stamp must be applied to the ticket, card, pass, or other evidence of the right to admission, at the place where it is issued. All tickets, passes, cards or other evidence of the right to admission issued before November 1, but used after November 1, must be "validated" before they are used by collecting the tax and stamping them in accordance with the above requirements.

Where there is no box office price, the amount so paid for admission is taxable.

Traveling theatrical companies paying special taxes as theaters, not showing in regular buildings built and

rented for that purpose, should collect the tax on admissions. If they show in regular theaters or opera houses the owners of such houses should collect and file the returns. Where the proprietor of a theater leases his premises and reserves a box for his own use, the tax collected on this box is the same as that collected on any other box or like accommodation at the same theater. One who rents or leases a theater outright for one or more performances must make return and pay the tax, but the proprietor of the theater is required to show in his returns the dates when and the parties to whom he rents or leases the place.

Where theaters are not permitted to charge admission but overcome the difficulty by taking a "silver collection" at the door there is no objection to selling revenue tickets with each contribution, a ten-cent contributor paying 11 cents.

The following is an illustration of the computation of the tax on admissions applicable to theaters and other places where the rate of tax is 1 cent for each 10 cents or fraction:

Admission	35 cents	*tax* 4 cents	*total to be collected* 39 cents
Reserved Seats	25 cents	" 3 cents	" " " 28 cents
Reserved Seats	15 cents	" 2 cents	" " " 17 cents
Admission	25 cents	" 3 cents	" " " 28 cents
Admission	10 cents	" 1 cent	" " " 11 cents
Admission (child)	5 cents	" 1 cent	" " " 6 cents

There is no stamp tax on such tickets: the seller of the ticket collects the tax computed on each ticket separately. Daily cash register receipts cannot be taken as a basis for computing the amount of tax due, unless all admissions are 10 cents or multiples of 10 cents.

The aggregate amount of tax is to be entered in the return, computed as above directed, upon each admission and each free admission separately. In computing the tax upon each payment, a fraction of a cent is to be disregarded unless it amounts to one half cent or more, in which case it is to be counted as one cent.

Airdomes. — Airdomes do not come within the exemption of open-air parks, and admissions thereto are taxable.

Dance halls.—Admissions to dance halls are taxable, but charges for the privilege of dancing, in addition to the charges for admission, are not taxable. If a group of people get together and take up a collection or contribution of money to pay for the music, such collection or contribution would not be regarded as price paid for admission to a dance.

Sums paid for private dancing or class lessons are not subject to tax.

Cabarets.—In the case of cabarets or other similar entertainments to which the charge for admission is wholly or in part included in the price paid for refreshment, service, or merchandise, the amount paid for admission is estimated by the Treasury Department as being one-fifth of the patron's total bill. The tax, accordingly, is 1 cent for each 10 cents or fraction thereof of an amount equal to 20 per cent of the bill, unless satisfactory evidence is presented to the Collector that a different percentage should be fixed. For example: if the bill amounts to $5, the tax is 10 cents. A fraction of a cent is to be disregarded unless it amounts to one half cent or more, in which case it is increased to 1 cent. Tips are not to be included in the amount which forms the basis of the tax. Cabarets include any place in which any entertainment is conducted in connection with the sale of food, refreshments, etc., except that the tax does not apply to hotels, restaurants, etc., where only instrumental music is furnished, but does apply if there is dancing by the patrons.

Returns, in the case of cabarets, must be made on or before the 10th day of each month. (T. D. 2603.)

Miscellaneous admissions.—Taxable admissions include those to Sunday afternoon orchestral concerts, admissions to caves and similar exhibitions, and admissions to food shows.

Athletic and racing associations.—Admissions to college athletic exhibitions, as well as to any other similar exhibitions, such as track meets, football and baseball games, are taxable, unless all the net proceeds are given to the college itself, or to some other institution exempt from taxation under the Act.

The tax attaches upon subscriptions to racing associations regardless of whether or not the subscriber attends any of the meets. The association itself may pay the tax due for any person admitted free.

The provision of the section which allows bona-fide employees to be admitted tax-free applies only to actual employees of the association and not to employees of the owners of racing horses.

Fairs.—Agricultural fair associations must collect and pay the tax if any of the proceeds are distributed to members or stockholders of the association. If no such profits are to be so distributed the tax does not attach to admission charges.

Club dues.—Dues or fees admitting to membership in social clubs are taxable at the rate of 10 per cent, if such dues exceed $12 a year.

Any organization which maintains headquarters for the purpose of affording its members the opportunity of informally congregating for social intercourse is a social club within the meaning of the law, and the dues therefore are taxable. Business men's oganizations, such as Chambers of Commerce, are not taxable, however, by reason of the fact that social features may be included in their meetings with the object of maintaining their membership for business purposes.

Tax must be paid upon all dues representing membership privileges for any time elapsing after October 31, 1917, regardless of the time of payment. Thus, in a case of dues exceeding $12 a year paid for the calendar year 1917, a tax will be due on one-sixth of the full amount paid for such calendar year, irrespective of the date of payment.

Where a club charges an initiation fee in addition to annual dues the taxability of the club is estimated upon the annual dues plus the initiation fee.

Assessment dues; life membership fees; college fraternity dues; and "green fees" paid by a member of a golf club for a guest are all taxable.

Where the annual dues exceed $12, but are paid in two or more annual installments, the payments are taxable when made, pro rata.

The tax does not attach in a case where the only initiation fee charged is the purchase of a share of stock in the club.

Where membership entitles a member to admission with one guest, no further tax is required for admission of such guest. Other guests admitted free of charge, however, must pay the tax.

The tax on club dues may be paid by the clubs themselves.

Y. M. C. A. and Y. M. H. A. dues and admissions are not taxable.

Returns.—Every person, corporation, partnership or association receiving payment for admissions, or admitting any person free, is obligated to collect the tax due in each case and to make returns as provided in section 503 of the Act.

Returns must be made in duplicate on or before the last day of each month covering the preceding month (in the case of cabarets on the 10th of each month), and the tax required to be collected must be paid over to the collector of the district in which is situated the principal office or place of business. This return is made on Form 729.

There must be kept in each box or ticket office of every theater, place of amusement, or other place to which admissions subject to the tax are charged a daily record of the number and kind of tickets sold and the tax collected thereon. Such record must also show the num-

ber of passes used for admission each day and the tax collected thereon and the number of admissions of children under twelve years of age and the tax collected thereon. Each separate class of tickets sold must be so distinctly indicated as to be capable of ready verification by the Internal Revenue Department. A separate record must be kept of the number and kind of tickets, cards, passes or other evidence of right to admission on or after November 1, 1917, paid for or issued prior to November 1 and of the tax collected in respect thereof. The monthly return required to be filed by proprietors of all places to which admission is charged, not expressly exempt from taxation, must include and cover amounts collected on validation of tickets, passes, cards, or other evidence of the right to admission.

In computing the tax, a fraction of a cent is to be disregarded unless it amounts to one half cent or more, in which case it is to be counted as one cent. Such fractions, however, are likely to be encountered only in cases where the tax is a straight percentage of the charge for admission. Where the tax is 1 cent for each 10 cents or fraction thereof of the price of admission, no fractions of cents will be encountered.

Penalties.—The penalties are: for failure to submit a return within the time prescribed, a fine of not more than $1,000 or imprisonment for not more than one year, or both; and for failure to collect or truly to account for and pay over the tax, an additional penalty of double the tax not collected or accounted for.

A recent decision of the Treasury Department in the case of the stamp tax on railroad tickets construes the penalty for non-payment as being also upon the purchaser of the ticket; it seems possible that a similar construction of the law might be made to apply in the case of the tax on admissions and dues.

Where a club charges an initiation fee in addition to annual dues the taxability of the club is estimated upon the annual dues plus the initiation fee.

Assessment dues; life membership fees; college fraternity dues; and "green fees" paid by a member of a golf club for a guest are all taxable.

Where the annual dues exceed $12, but are paid in two or more annual installments, the payments are taxable when made, pro rata.

The tax does not attach in a case where the only initiation fee charged is the purchase of a share of stock in the club.

Where membership entitles a member to admission with one guest, no further tax is required for admission of such guest. Other guests admitted free of charge, however, must pay the tax.

The tax on club dues may be paid by the clubs themselves.

Y. M. C. A. and Y. M. H. A. dues and admissions are not taxable.

Returns.—Every person, corporation, partnership or association receiving payment for admissions, or admitting any person free, is obligated to collect the tax due in each case and to make returns as provided in section 503 of the Act.

Returns must be made in duplicate on or before the last day of each month covering the preceding month (in the case of cabarets on the 10th of each month), and the tax required to be collected must be paid over to the collector of the district in which is situated the principal office or place of business. This return is made on Form 729.

There must be kept in each box or ticket office of every theater, place of amusement, or other place to which admissions subject to the tax are charged a daily record of the number and kind of tickets sold and the tax collected thereon. Such record must also show the num-

ber of passes used for admission each day and the tax collected thereon and the number of admissions of children under twelve years of age and the tax collected thereon. Each separate class of tickets sold must be so distinctly indicated as to be capable of ready verification by the Internal Revenue Department. A separate record must be kept of the number and kind of tickets, cards, passes or other evidence of right to admission on or after November 1, 1917, paid for or issued prior to November 1 and of the tax collected in respect thereof. The monthly return required to be filed by proprietors of all places to which admission is charged, not expressly exempt from taxation, must include and cover amounts collected on validation of tickets, passes, cards, or other evidence of the right to admission.

In computing the tax, a fraction of a cent is to be disregarded unless it amounts to one half cent or more, in which case it is to be counted as one cent. Such fractions, however, are likely to be encountered only in cases where the tax is a straight percentage of the charge for admission. Where the tax is 1 cent for each 10 cents or fraction thereof of the price of admission, no fractions of cents will be encountered.

Penalties.—The penalties are: for failure to submit a return within the time prescribed, a fine of not more than $1,000 or imprisonment for not more than one year, or both; and for failure to collect or truly to account for and pay over the tax, an additional penalty of double the tax not collected or accounted for.

A recent decision of the Treasury Department in the case of the stamp tax on railroad tickets construes the penalty for non-payment as being also upon the purchaser of the ticket; it seems possible that a similar construction of the law might be made to apply in the case of the tax on admissions and dues.

CHAPTER XXX

WAR TAX ON ADMISSIONS AND DUES LAW

BEING TITLE VII OF "AN ACT TO PROVIDE REVENUE TO DEFRAY WAR EXPENSES, AND FOR OTHER PURPOSES," APPROVED OCTOBER 3, 1917. (PUBLIC—No. 50—65th CONGRESS). IN EFFECT OCTOBER 4, 1917, UNLESS OTHERWISE SPECIALLY PROVIDED.

TITLE VII.—WAR TAX ON ADMISSIONS AND DUES, EFFECTIVE NOV. 1, 1917.

Amount of tax on admissions.—Sec. 700 [of the general revenue Act of which this Title is a part]. That from and after the first day of November, nineteen hundred and seventeen, there shall be levied, assessed, collected, and paid, (*a*) a tax of 1 cent for each 10 cents or fraction thereof of the amount paid for admission to any place, including admission by season ticket or subscription, to be paid by the person paying for such admission: *Provided,* That the tax on admission of children under twelve years of age where an admission charge for such children is made shall in every case be 1 cent; and

Tax on free admissions and passes, except in certain cases.—(*b*) In the case of persons (except bona fide employees, municipal officers on official business, and children under twelve years of age) admitted free to any place at a time when and under circumstances under which an admission charge is made to other persons of the same class, a tax of 1 cent for each 10 cents or

fraction thereof of the price so charged to such other persons for the same or similar accommodations, to be paid by the persons so admitted; and

Tax on cabarets.—(*c*) A tax of 1 cent for each 10 cents or fraction thereof paid for admission to any public performance for profit at any cabaret or other similar entertainment to which the charge for admission is wholly or in part included in the price paid for refreshment, service, or merchandise; the amount paid for such admission to be computed under rules prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, such tax to be paid by the person paying for such refreshments, service, or merchandise.

Tax on reserved boxes or seats.—In the case of persons having the permanent use of boxes or seats in an opera house or any place of amusement or a lease for the use of such box or seat in such opera house or place of amusement there shall be levied, assessed, collected, and paid a tax equivalent to ten per centum of the amount for which a similar box or seat is sold for performance or exhibition at which the box or seat is used or reserved by or for the lessee or holder.

When 5 and 10-cent admissions are exempt.—These taxes shall not be imposed in the case of a place the maximum charge for admission to which is 5 cents, or in the case of shows, rides, and other amusements, (the maximum charge for admission to which is ten cents) within outdoor general amusement parks, or in the case of admissions to such parks.

Other exemptions.—No tax shall be levied under this title in respect to any admissions all the proceeds of which inure exclusively to the benefit of religious, educational, or charitable institutions, societies, or organizations, or admissions to agricultural fairs, none of the profits of which are distributed to stockholders or members of the association conducting the same.

Definition of admission.—The term "admission" as used in this title includes seats and tables, reserved or otherwise, and other similar accommodations, and the charges made therefor.

Tax on dues and membership fees.—Sec. 701. That from and after the first day of November, nineteen hundred and seventeen, there shall be levied, assessed, collected, and paid, a tax equivalent to ten per centum of any amount paid as dues or membership fees (including initiation fees), to any social, athletic, or sporting club or organization, where such dues or fees are in excess of $12 per year; such taxes to be paid by the person paying such dues or fees:

Specific exemptions.—*Provided,* That there shall be exempted from the provisions of this section all amounts paid as dues or fees to a fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

Method of payment of taxes.—Sec. 702. That every person, corporation, partnership, or association (*a*) receiving any payments for such admission, dues, or fees, shall collect the amount of the tax imposed by section seven hundred or seven hundred and one from the person making such payments, or (*b*) admitting any person free to any place for admission to which a charge is made shall collect the amount of the tax imposed by section seven hundred from the person so admitted, and (*c*) in either case shall make returns and payments of the amounts so collected, at the same time and in the same manner as provided in section five hundred and three of this Act.

Approved by the President, October 3, 1917.

CHAPTER XXXI

COLLECTION DISTRICTS

AND NAMES AND ADDRESSES OF COLLECTORS.

(The name of the collection district is the same, unless otherwise indicated, as the name of the State in which the collector has his residence.)

ALABAMA (Includes Mississippi), *John D. McNeel,* Birmingham.

ALASKA (See Washington).

ARIZONA (See New Mexico).

ARKANSAS, Jack Walker, Little Rock.

CALIFORNIA:

First District.—The counties of Alameda, Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, Eldorado, Fresno, Glenn, Humboldt, Inyo, Kings, Lake, Lassen, Madera, Marin, Mariposa, Mendocino, Merced, Modoc, Mono, Monterey, Napa, Nevada, Placer, Plumas, Sacramento, San Benito, San Francisco, San Joaquin, San Mateo, Santa Clara, Santa Cruz, Shasta, Sierra, Siskiyou, Solano, Sonoma, Stanislaus, Sutter, Tulare, Tehama, Trinity, Tuolumne, Yolo, Yuba, and the State of Nevada, *Justus S. Wardell,* San Francisco.

Sixth District.—The counties of Imperial, Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, San Luis Obispo, Santa Barbara, and Ventura, *John P. Carter,* Los Angeles.

COLORADO (Including Wyoming), *Mark A. Skinner,* Denver.

CONNECTICUT (Includes Rhode Island), *James J. Walsh,* Hartford.

DELAWARE (See Maryland).

DISTRICT OF COLUMBIA (See Maryland).

FLORIDA, James M. Cathcart, Jacksonville.

GEORGIA, Aaron O. Blalock, Atlanta.

HAWAII, John F. Haley, Honolulu.

IDAHO (See Montana).

ILLINOIS:

First District.—The counties of Boone, Carroll, Cook, DeKalb, Dupage, Grundy, Jo Daviess, Kane, Kankakee, Kendall, Lake, Lasalle, Lee, McHenry, Ogle, Stephenson, Whiteside, Will, and Winnebago, *Julius F. Smietanka,* Chicago.

Fifth District.—The counties of Bureau, Henderson, Henry, Knox, Marshall, Mercer, Peoria, Putnam, Rock Island, Stark, and Warren, *Edward D. McCabe,* Peoria.

Eighth District.—The counties of Adams, Bond, Brown, Calhoun, Cass, Champaign, Christian, Coles, Cumberland, Dewitt, Douglas, Edgar, Ford, Fulton, Greene, Hancock, Iroquois, Jersey, Livingston, Logan, McDonough, McLean, Macon, Macoupin, Mason, Menard, Montgomery, Morgan, Moultrie, Piatt, Pike, Sangamon, Schuyler, Scott, Shelby, Tazewell, Vermilion, and Woodford, *John L. Pickering,* Springfield.

Thirteenth District.—The counties of Alexander, Clark, Clay, Clinton, Crawford, Edwards, Effingham, Fayette, Franklin, Gallatin, Hamilton, Hardin, Jackson, Jasper, Jefferson, Johnson, Lawrence, Madison, Marion, Massac, Monroe, Perry, Pope, Pulaski, Randolph, Richland, St. Clair, Saline, Union, Wabash, Washington, Wayne, White, and Williamson, *John M. Rapp,* East St. Louis.

INDIANA:

Sixth District.—The counties of Adams, Allen, Bartholomew, Benton, Blackford, Brown, Cass, Dearborn, Decatur, Dekalb, Delaware, Elkhart, Fayette, Franklin, Fulton, Grant, Hamilton, Hancock, Hendricks, Henry, Howard, Huntington, Jackson, Jasper, Jay, Jefferson, Jennings, Johnson, Kosciusko, Lagrange, Lake, Laporte, Lawrence, Madison, Marion, Marshall, Miami, Monroe, Morgan, Newton, Noble, Ohio, Porter, Pulaski, Randolph, Ripley, Rush, St. Joseph, Shelby, Starke, Steuben, Switzerland, Tipton, Union, Wabash, Wayne, Wells, White, and Whitley. *Peter J. Kruyer,* Indianapolis.

Seventh District.—The counties of Boone, Carroll, Clark, Clay, Clinton, Crawford, Daviess, Dubois, Floyd, Fountain, Gibson, Greene, Harrison, Knox, Martin, Montgomery, Orange, Owen, Parke, Perry, Pike, Posey, Putnam, Scott, Spencer, Sullivan, Tippecanoe, Vanderburg, Vermilion, Vigo, Warren, Warrick, and Washington. *Isaac R. Strouse,* Terre Haute.

IOWA, Louis Murphy, Dubuque.

KANSAS, Wm. H. L. Pepperell, Wichita.

KENTUCKY:

Second District.—The counties of Allen, Ballard, Barren, Breckenridge, Butler, Caldwell, Calloway, Carlisle, Christian, Clinton, Crittenden, Cumberland, Daviess, Edmonson, Fulton, Graves, Grayson, Hancock, Hart, Henderson, Hickman, Hopkins, Livingston, Logan, Lyon, McCracken, McLean, Marshall, Metcalfe, Monroe, Muhlenberg, Ohio, Russell, Simpson, Todd, Trigg, Union, Warren, and Webster, *Josh T. Griffith,* Owensboro.

Fifth District.—The city of Louisville and the counties of Adair, Bullitt, Casey, Green, Hardin, Henry, Jefferson, Larue, Marion, Meade, Nelson,

Oldham, Owen, Shelby, Spencer, Taylor, and Washton, *Thomas S. Mayes,* Louisville.

Sixth District.—The counties of Boone, Bracken, Campbell, Carroll, Gallatin, Grant, Harrison, Kenton, Pendleton, Robertson, and Trimble, *Charlton B. Thompson,* Covington.

Seventh District.—The counties of Bath, Bourbon, Boyd, Carter, Clark, Elliott, Fayette, Fleming, Franklin, Greenup, Johnson, Lawrence, Lewis, Martin, Mason, Menifee, Montgomery, Morgan, Nicholas, Powell, Rowan, Scott, and Woodford, *Ben Marshall,* Lexington.

Eighth District.—The counties of Anderson, Bell, Boyle, Breathitt, Clay, Estill, Floyd, Garrard, Harlan, Jackson, Jessamine, Knott, Knox, Laurel, Lee, Leslie, Letcher, Lincoln, Madison, Magoffin, Mercer, McCreary, Owsley, Perry, Pike, Pulaski, Rockcastle, Wayne, Whitley, and Wolfe, *John W. Hughes,* Danville.

LOUISIANA, John Y. Fauntleroy, New Orleans.

MAINE (See New Hampshire).

MARYLAND, Joshua W. Miles, Baltimore.

District of Maryland consists of the following-named territory: The State of Maryland and Delaware, the District of Columbia, and the counties of Accomac and Northampton of the State of Virginia.

MASSACHUSETTS, John F. Malley, Boston.

This district is officially designated as the Third District of Massachusetts.

MICHIGAN,

First District.—Counties of Alcona, Alpena, Arenac, Bay, Branch, Calhoun, Cheboygan, Clare, Clinton, Crawford, Genessee, Gladwin, Gratiot, Hillsdale, Huron, Ingham, Iosco, Isabella, Jackson, Lapeer, Lenawee, Livingston, Macomb, Midland, Monroe, Montmorency, Oakland, Ogemaw, Oscoda, Ot-

sego, Presque Isle, Roscommon, Saginaw, Sanilac, Shiawassee, St. Clair, Tuscola, Washtenaw, and Wayne, *James J. Brady,* Detroit.

Fourth District.—Counties of Alger, Allegan, Antrim, Baraga, Barry, Benzie, Berrien, Cass, Charlevoix, Chippewa, Delta, Dickinson, Eaton, Emmet, Gogebic, Grand Traverse, Houghton, Ionia, Iron, Kalamazoo, Kaikaska, Kent, Keweenaw, Lake, Leelanau, Luce, Mackinac, Manistee, Marquette, Mason, Mecosta, Menominee, Missaukee, Montcalm, Muskegon, Newaygo, Oceana, Ontonagon, Osceola, Ottawa, St. Joseph, Schoolcraft, Van Buren, and Wexford, *Emanuel L. Doyle,* Grand Rapids.

MINNESOTA, Edward J. Lynch, St. Paul.

MISSISSIPPI (See Alabama).

The State of Mississippi detached from the District of Louisiana and added to the District of Alabama June 1, 1908.

MISSOURI,

First District.—The counties of Adair, Audrain, Bollinger, Boone, Butler, Callaway, Cape Girardeau, Carter, Clark, Crawford, Dent, Dunklin, Franklin, Gasconade, Howard, Iron, Jefferson, Knox, Lewis, Lincoln, Linn, Macon, Madison, Maries, Marion, Mississippi, Montgomery, Monroe, New Madrid, Oregon, Osage, Pemiscot, Perry, Phelps, Pike, Pulaski, Ralls, Randolph, Reynolds, Ripley, St. Charles, St. Francois, Ste. Genevieve, St. Louis, Schuyler, Scotland, Scott, Shannon, Shelby, Stoddard, Warren, Washington, and Wayne, *George H. Moore,* St. Louis.

Sixth District.—The counties of Andrew, Atchison, Barry, Barton, Bates, Benton, Buchanan, Caldwell, Camden, Carroll, Cass, Cedar, Chariton, Christian, Clay, Clinton, Cole, Cooper, Dade, Dallas, Daviess, Dekalb, Douglas, Gentry, Greene, Grundy,

Harrison, Henry, Hickory, Holt, Howell, Jackson, Jasper, Johnson, Laclede, Lafayette, Lawrence, Livingston, McDonald, Mercer, Miller, Moniteau, Morgan, Newton, Nodaway, Ozark, Pettis, Platte, Polk, Putnam, Ray, St. Clair, Saline, Stone, Sullivan, Taney, Texas, Vernon, Webster, Worth, and Wright, *Edgar M. Harber,* Kansas City.

MONTANA (Includes Utah and Idaho), *William C. Whaley, Helena.*

NEBRASKA, Geo. L. Loomis, Omaha.

NEVADA (See First California).

NEW HAMPSHIRE (Includes Maine and Vermont), *Seth W. Jones,* Portsmouth.

NEW JERSEY:

First District.—The counties of Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Mercer, Monmouth, Ocean, and Salem, *Samuel Iredell,* Camden.

Fifth District.—The counties of Bergen, Essex, Hudson, Hunterdon, Middlesex, Morris, Passaic, Somerset, Sussez, Union, and Warren, *Charles V. Duffy,* Newark.

NEW MEXICO (Includes Arizona), *Lewis T. Carpenter,* Phoenix, Arizona.

NEW YORK:

First District.—The counties of Kings, Nassau, Queens, Richmond, and Suffolk, *Henry P. Keith,* Brooklyn.

Second District.—The old first, second, third, fourth, fifth, sixth, eighth, ninth, and fifteenth wards of New York City; that portion of the old fourteenth ward lying west of the centre of Mott Street; that portion of the old sixteenth ward lying south of the centre of West Twenty-fourth Street, and Governors Island, *William H. Edwards,* Custom House, New York.

Third District.—The old seventh, tenth, eleventh, twelfth, thirteenth, seventeenth, eighteenth, nineteenth, twentieth, twenty-first, and twenty-second wards of New York City; that part of the old fourteenth ward lying east of the centre of Mott Street; that part of the old sixteenth ward lying north of the center of West Twenty-fourth Street, and Blackwells, Randalls, and Wards Islands, *Mark Eisner,* 1150 Broadway (27th Street), New York.

Fourteenth District.—The counties of Albany, Clinton, Columbia, Dutchess, Essex, Fulton, Greene, Hamilton, Montgomery, Orange, Putnam, Rensselaer, Rockland, Saratoga, Schenectady, Schoharie, Sullivan, Ulster, Warren, Washington, and Westchester, and the old twenty-third and twenty-fourth wards of New York City, *Roscoe Irwin,* Albany

Twenty-first District.—The counties of Broome, Cayuga, Chenango, Cortland, Delaware, Franklin, Herkimer, Jefferson, Lewis, Madison, Oneida, Onondaga, Oswego, Otsego, St. Lawrence, Schuyler, Seneca, Tioga, Tompkins, and Wayne, *Neil Brewster,* Syracuse.

Twenty-eighth District.—The counties of Allegany, Cattaraugus, Chautauqua, Chemung, Erie, Genessee, Livingston, Monroe, Niagara, Ontario, Orleans, Steuben, Wyoming, and Yates, *Vincent H. Riordan,* Buffalo.

NORTH CAROLINA:

Fourth District. — The counties of Alamance, Beaufort, Bertie, Bladen, Brunswick, Camden, Carteret, Caswell, Chatham, Chowan, Columbus, Craven, Cumberland, Currituck, Dare, Duplin, Durham, Edgecombe, Franklin, Gates, Granville, Greene, Halifax, Harnett, Hertford, Hyde, Johnston, Jones, Lenoir, Martin, Montgomery, Moore, Nash, New Hanover, Northampton, Onslow, Orange, Pamlico, Pasquotank, Pender, Perquimans, Person, Pitt,

Richmond, Robeson, Sampson, Scotland, Tyrrell, Vance, Wake, Warren, Washington, Wayne, and Wilson, *Josiah W. Bailey,* Raleigh.

Fifth District.—The counties of Alexander, Allegany, Anson, Ashe, Buncombe, Burke, Cabarrus, Caldwell, Catawba, Cherokee, Clay, Cleveland, Davidson, Davie, Forsyth, Gaston, Graham, Guilford, Haywood, Henderson, Iredell, Jackson, Lincoln, McDowell, Macon, Madison, Mecklenburg, Mitchell, Polk, Randolph, Rockingham, Rowan, Rutherford, Stanly, Stokes, Surry, Swain, Transylvania, Union, Watauga, Wilkes, Yadkin, and Yancey, *Alston D. Watts,* Statesville.

NORTH AND SOUTH DAKOTA, James Coffey, Aberdeen, S. Dakota.

OHIO:

First District.—The counties of Brown, Butler, Clarke, Clermont, Clinton, Fayette, Greene, Hamilton, Highland, Miami, Montgomery, Preble, and Warren, *Andrew C. Gilligan,* Cincinnati.

Tenth District.—The counties of Allen, Auglaize, Champaign, Crawford, Darke, Defiance, Erie, Fulton, Hancock, Hardin, Henry, Huron, Logan, Lucas, Mercer, Ottawa, Paulding, Putnam, Sandusky, Seneca, Shelby, Van Wert, Williams, Wood, and Wyandot, *Frank B. Niles,* Toledo.

Eleventh District. — The counties of Adams, Athens, Coshocton, Delaware, Fairfield, Franklin, Gallia, Guernsey, Hocking, Jackson, Knox, Lawrence, Licking, Madison, Marion, Meigs, Morgan, Morrow, Muskingum, Noble, Perry, Pickaway, Pike, Ross, Scioto, Union, Vinton, and Washington, *Beriah E. Williamson,* Columbus.

Eighteenth District.—The counties of Ashland, Ashtabula, Belmont, Carroll, Columbiana, Cuyahoga, Geauga, Harrison, Holmes, Jefferson, Lake,

Lorain, Mahoning, Medina, Monroe, Portage, Richland, Stark, Summit, Trumbull, Tuscarawas, and Wayne, *Harry H. Weiss,* Cleveland.

OKLAHOMA, Hubert L. Bolen, Oklahoma City.

OREGON, Milton A. Miller, Portland.

PENNSYLVANIA:

First District.—The counties of Berks, Bucks, Chester, Delaware, Lehigh, Montgomery, Philadelphia, and Schuylkill, *Ephraim Lederer,* Philadelphia.

Ninth District.—The counties of Adams, Bedford, Blair, Cumberland, Dauphin, Franklin, Fulton, Huntingdon, Juniata, Lancaster, Lebanon, Mifflin, Perry, Snyder, York, *Benjamin F. Davis,* Lancaster.

Twelfth District.—Bradford, Carbon, Center, Clinton, Columbia, Lackawanna, Luzerne, Lycoming, Monroe, Montour, Northampton, Northumberland, Pike, Potter, Sullivan, Susquehanna, Tioga, Union, Wayne, Wyoming. (Twelfth District reestablished May 1, 1915.) *Fred C. Kirkendall,* Scranton.

Twenty-third District.—The counties of Allegheny, Armstrong, Beaver, Butler, Cambria, Cameron, Clarion, Clearfield, Crawford, Elk, Erie, Fayette, Forest, Greene, Indiana, Jefferson, Lawrence, McKean, Mercer, Somerset, Venango, Warren, Washington, and Westmoreland, *C. Gregg Lewellyn,* Pittsburgh.

PHILIPPINE ISLANDS, James J. Rafferty, Manila.

RHODE ISLAND (See Connecticut).

SOUTH CAROLINA, Duncan C. Heyward, Columbia.

SOUTH DAKOTA (See North and South Dakota).

TENNESSEE, Edward B. Craig, Nashville.

TEXAS, Alexander S. Walker, Austin.

UTAH (See Montana).

VERMONT (See New Hampshire).

VIRGINIA:

Second District.—The counties of Amelia, Appomattox, Brunswick, Buckingham, Caroline, Charles City, Chesterfield, Cumberland, Dinwiddie, Elizabeth City, Essex, Fluvanna, Gloucester, Goochland, Greensville, Hanover, Henrico, Isle of Wight, James City, King and Queen, King George, King William, Lancaster, Louisa, Lunenburg, Mathews, Middlesex, Nansemond, New Kent, Norfolk, Northumberland, Nottaway, Powhatan, Prince Edward, Prince George, Princess Anne, Richmond, Stafford, Southampton, Spottsylvania, Surry, Sussex, Warwick, Westmoreland, and York, *Richard C. L. Moncure,* Richmond.

Sixth District.—The counties of Albemarle, Alexandria, Alleghany, Amherst, Augusta, Bath, Bedford, Bland, Botetourt, Buchanan, Campbell, Carroll, Charlotte, Clarke, Craig, Culpeper, Dickenson, Fairfax, Fauquier, Floyd, Franklin, Frederick, Giles, Grayson, Greene, Halifax, Henry, Highland, Lee, Loudoun, Madison, Mecklenburg, Montgomery, Nelson, Orange, Page, Patrick, Pittsylvania, Prince William, Pulaski, Rappahannock, Roanoke, Rockbridge, Rockingham, Russell, Scott, Shenandoah, Smyth, Tazewell, Warren, Washington, Wise, and Wythe, *John M. Hart,* Roanoke.

The counties of Accomac and Northampton are in the District of Maryland.

WASHINGTON (Includes Alaska), *David J. Williams,* Tacoma.

WEST VIRGINIA, Samuel A. Hays, Parkersburg.

WISCONSIN:

First District. — Counties of Brown, Calumet, Dodge, Door, Florence, Fond du Lac, Forest, Green Lake, Kenosha, Kewaunee, Monitowoc, Marinette, Marquette, Milwaukee, Oconto, Outogamie, Ozau-

kee, Racine, Shawano, Sheboygan, Walworth, Washington, Waukesha, Waupaca, Waushara, Winnebago, and county of Langlade with exception of the eight townships of said county which were formerly in Lincoln County, *Paul A. Hemmy,* Milwaukee.

Second District.—Counties of Adams, Ashland, Barron, Bayfield, Buffalo, Burnett, Chippewa, Clark, Columbia, Crawford, Dane, Douglas, Dunn, Eau Clair, Grant, Green, Iowa, Iron, Jackson, Jefferson, Juneau, La Crosse, Lafayette, Lincoln, Marathon, Monroe, Oneida, Pepin, Pierce, Polk, Portage, Price, Richland, Rock, Rusk, St. Croix, Sauk, Sawyer, Taylor, Trempealeau, Vernon, Vilas, Washburn, Wood, and the eight townships in the western part of Langlade County which were formerly in Lincoln County, *Burt Williams,* Madison.

WYOMING (See Colorado).

A list of the several

INTERNAL REVENUE DIVISIONS

with the

NAMES AND ADDRESSES OF AGENTS IN CHARGE

Corrected to July 25, 1917

ALABAMA .... See Nashville Division.
ALASKA .... See Portland Division.
ARIZONA .... See Denver Division.
ARKANSAS .... See Little Rock Division.
CALIFORNIA .... See San Francisco Division.
COLORADO .... See Denver Division.
CONNECTICUT ...... See New Haven Division.
DELAWARE .... See Baltimore Division.
DIST. OF COLUMBIA. See Baltimore Division.
FLORIDA .... See Atlanta Division.
GEORGIA .... See Atlanta Division.

HAWAII ....See San Francisco Division.
IDAHO ....See Salt Lake Division.
ILLINOIS ....See Chicago and Springfield Divisions.
INDIANA ....See Indianapolis Division.
IOWA ....See Omaha Division.
KANSAS ....See Little Rock Division.
KENTUCKY ....See Huntington and Louisville Divisions.
LOUISIANA ....See New Orleans Division.
MAINE ....See Boston Division.
MARYLAND ....See Baltimore Division.
MASSACHUSETTS ...See Boston Division.
MICHIGAN ....See Detroit Division.
MINNESOTA ....See St. Paul Division.
MISSISSIPPI ....See New Orleans Division.
MISSOURI ....See St. Louis Division.
MONTANA ....See Salt Lake Division.
NEBRASKA ....See Omaha Division.
NEVADA ....See San Francisco Division.
NEW HAMPSHIRE...See Boston Division.
NEW JERSEY........See Elizabeth Division.
NEW MEXICO........See Denver Division.
NEW YORK...........See Buffalo, New Haven and New York Divisions.
NORTH CAROLINA...See Greensboro Division.
NORTH DAKOTA.....See St. Paul Division.
OHIO ....See Cincinnati and Cleveland Divisions.
OKLAHOMA ....See Little Rock Division.
OREGON ....See Portland Division.
PENNSYLVANIA .....See Philadelphia and Pittsburgh Divisions.
RHODE ISLAND......See New Haven Division.
SOUTH CAROLINA...See Greensboro Division.
SOUTH DAKOTA.....See St. Paul Division.
TENNESSEE ....See Nashville Division.

TEXAS .... See San Antonio Division.
UTAH .... See Salt Lake Division.
VERMONT .... See Boston Division.
VIRGINIA .... See Richmond Division.
WASHINGTON .... See Portland Division.
WEST VIRGINIA..... See Huntington Division.
WISCONSIN .... See Milwaukee Division.
WYOMING .... See Denver Division.

Atlanta Division, E. C. Yellowley, Atlanta, Ga.
Georgia and Florida.

Baltimore Division, E. A. Forbes, Baltimore, Md.
Maryland, Delaware and District of Columbia.

Boston Division, R. C. Shelley, Boston, Mass.
Maine, New Hampshire, Vermont and Massachusetts.

Buffalo Division, S. D. Amen, Buffalo, N. Y.
21st and 28th Districts of New York.

Chicago Division, Dan J. Chapin, Chicago, Ill.
1st and 5th Districts of Illinois.

Cincinnati Division, T. E. Stone, Cincinnati, Ohio.
1st and 11th Districts of Ohio.

Cleveland Division, W. H. Collier, Cleveland, Ohio.
10th and 18th Districts of Ohio.

Denver Division, Harvey H. Slusser, Denver, Col.
Colorado, Wyoming, New Mexico and Arizona.

Detroit Division, Lee A. Miller, Detroit, Mich.
1st and 4th Districts of Michigan.

Elizabeth Division, D. K. Donaldson, Elizabeth, N. J.
1st and 5th Districts of New Jersey.

Greensboro Division, T. H. Vanderford, Greensboro, N. C.
North and South Carolina.

Huntington Division, James O'Brien, Huntington, W. Va.
West Virginia and the 7th District of Kentucky.

Indianapolis Division, GEO. W. TROWBRIDGE, Indianapolis, Ind.
6th and 7th Districts of Indiana.

Little Rock Division, JAS. S. BARKMAN, Little Rock, Ark.
Arkansas, Oklahoma and Kansas.

Louisville Division, WM. D. CHANDLER, Louisville, Ky.
2nd, 5th, 6th, and 8th Districts of Kentucky.

Milwaukee Division, JAMES W. MCGINNIS, Milwaukee, Wis.
1st and 2nd Districts of Wisconsin.

Nashville Division, DANIEL L. PORTER, Nashville, Tenn.
Tennessee and Alabama.

New Haven Division, THEO. M. BYXBEE, New Haven, Conn.
Rhode Island, Connecticut, and 14th District of New York, except Westchester County, and the 23rd and 24th Wards of New York City, being a part of the 14th District of New York.

New Orleans Division, J. O. BENDER, New Orleans, La.
Louisiana and Mississippi.

New York Division, L. G. NUTT, New York, N. Y.
1st, 2d and 3d Districts of New York, and Westchester County, and the 23rd and 24th Wards of New York City, being a part of the 14th District of New York.

Omaha Division, JOHN A. MCCABE, Omaha, Neb.
Iowa and Nebraska.

Philadelphia Division, JOHN W. SINSEL, Philadelphia, Pa.
1st and 12th Districts of Pennsylvania.

Pittsburgh Division, FRANK L. BOYD, Pittsburgh, Pa.
9th and 23rd Districts of Pennsylvania.

Portland Division, ALLEN CARNES, Portland, Ore.
Oregon, Washington and Alaska.

Richmond Division, S. R. BRAME, Richmond, Va.
2nd and 6th Districts of Virginia.

Salt Lake Division, W. H. CHAPMAN, Salt Lake, Utah.
Utah, Montana and Idaho.

San Antonio Division, Jas. J. Drakeford, San Antonio, Texas.

San Francisco Division, C. E. Boulden, San Francisco, Cal. California, Hawaii and Nevada.

Springfield Division, W. P. Smith, Springfield, Ill. 8th and 13th Districts of Illinois.

St. Louis Division, John M. Rodgers, St. Louis, Mo. 1st and 6th Districts of Missouri.

St. Paul Division, W. W. Anderson, St. Paul, Minn. Minnesota and North and South Dakota.

Collection Districts for New York City.

New York City (Greater New York) is embraced within four collection districts; the First, the Second, the Third and the Fourteenth New York.

First District. The Boroughs of Brooklyn, Queens and Richmond are in the First District; Office, Post Office, Brooklyn.

Second District. The Borough of Manhattan (Manhattan Island) itself consists of two collection districts, the Second and the Third. The Second District (Office —Custom House) consists of that portion of Manhattan Borough which is bounded by the East River from the center of Catharine Slip (Pier 26, E. R., four blocks north of Brooklyn Bridge) to the Battery; by the North River from the Battery to the center of West 24th Street (Pier 64, N. R.); and by a line, beginning at the North (Hudson) River, running east along the center of West Twenty-fourth Street to the center of Sixth Avenue, down the center of Sixth Avenue to the center of Fourteenth Street, east along the center of Fourteenth Street to the center of Fourth Avenue, down the center of Fourth Avenue to Cooper Square, around the north and east sides of Cooper Square (i. e., all of Cooper Square is in the Second District) to the east side of the Bowery, down the east side of the Bowery to the center of

East Houston Street (i. e., both sides of the Bowery north of East Houston Street are in the Second District), west along the center of East Houston Street to the center of Mott Street, down the center of Mott Street to the center of Canal Street, east along the center of Canal Street to the center of the Bowery, down the center of the Bowery to the center of Catharine Street (at Division Street), along the center of Catharine Street to Catharine Slip and across the center of Catharine Slip to the East River (Pier 26, E. R.). The Second District includes Governors Island also.

Third District. The Third District (Office, 1150 Broadway, between 26th and 27th Streets) embraces all of the rest of Manhattan Island; that is, all of Manhattan Borough not included within the boundaries of the Second District outlined above, together with Blackwell's, Randall's and Ward's Islands.

Fourteenth District. The rest of Greater New York, that is, all of Bronx Borough, which lies north and east of the Harlem Ship Canal and the Harlem River, is in the Fourteenth District (Office, Albany).

CHAPTER XXXII

WAR EXCESS PROFITS TAX LAW

BEING TITLE II OF "AN ACT TO PROVIDE REVENUE TO DEFRAY WAR EXPENSES, AND FOR OTHER PURPOSES," APPROVED OCTOBER 3, 1917 (PUBLIC—No. 50—65th CONGRESS) IN EFFECT OCTOBER 4, 1917, UNLESS OTHERWISE SPECIALLY PROVIDED

TITLE II.—WAR EXCESS PROFITS TAX, EFFECTIVE OCTOBER 4, 1917.

Definitions.—Sec. 200 [of the general revenue Act of which this Title is a part]. That when used in this title—

The term "corporation" includes joint-stock companies or associations, and insurance companies;

The term "domestic" means created under the law of the United States, or of any State, Territory, or District thereof, and the term "foreign" means created under the law of any other possession of the United States or of any foreign country or government;

The term "United States" means only the States, the Territories of Alaska and Hawaii, and the District of Columbia;

"Taxable year."—The term "taxable year" means the twelve months ending December thirty-first, excepting in the case of a corporation or partnership which has fixed its own fiscal year, in which case it means such

fiscal year. The first taxable year shall be the year ending December thirty-first, nineteen hundred and seventeen, except that in the case of a corporation or partnership which has fixed its own fiscal year, it shall be the fiscal year ending during the calendar year nineteen hundred and seventeen. If a corporation or partnership, prior to March first, nineteen hundred and eighteen, makes a return covering its own fiscal year, and includes therein the income received during that part of the fiscal year falling within the calendar year nineteen hundred and sixteen, the tax for such taxable year shall be that proportion of the tax computed upon the net income during such full fiscal year which the time from January first, nineteen hundred and seventeen, to the end of such fiscal year bears to the full fiscal year; and

"Pre-war period."—The term "pre-war period" means the calendar years nineteen hundred and eleven, nineteen hundred and twelve, and nineteen hundred and thirteen, or, if a corporation or partnership was not in existence or an individual was not engaged in a trade or business during the whole of such period, then as many of such years during the whole of which the corporation or partnership was in existence, or the individual was engaged in the trade or business.

"Trade" and "business."—The terms "trade" and "business" include professions and occupations.

"Net income" in case of foreign corporations and others.—The term "net income" means in the case of a foreign corporation or partnership or a non-resident alien individual, the net income received from sources within the United States.

Rates of Tax.—Sec. 201. That in addition to the taxes under existing law and under this Act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereinafter in this title referred

to as the tax) equal to the following percentages of the net income:

Twenty per centum of the amount of the net income in excess of the deduction (determined as hereinafter provided) and not in excess of fifteen per centum of the invested capital for the taxable year;

Twenty-five per centum of the amount of the net income in excess of fifteen per centum and not in excess of twenty per centum of such capital;

Thirty-five per centum of the amount of the net income in excess of twenty per centum and not in excess of twenty-five per centum of such capital;

Forty-five per centum of the amount of the net income in excess of twenty-five per centum and not in excess of thirty-three per centum of such capital; and

Sixty per centum of the amount of the net income in excess of thirty-three per centum of such capital.

All income of corporation or partnership deemed received from its business.—For the purpose of this title every corporation or partnership not exempt under the provisions of this section shall be deemed to be engaged in business, and all the trades and businesses in which it is engaged shall be treated as a single trade or business, and all its income from whatever source derived shall be deemed to be received from such trade or business.

Certain incomes not subject to this tax.—This title shall apply to all trades or businesses of whatever description, whether continuously carried on or not, except—

(*a*) In the case of officers and employees under the United States, or any State, Territory, or the District of Columbia, or any local subdivision thereof, the compensation or fees received by them as such officers or employees;

(*b*) Corporations exempt from tax under the provisions of section eleven of Title I of such Act of September eighth, nineteen hundred and sixteen, as amended

by this Act, and partnerships and individuals carrying on or doing the same business, or coming within the same description [for exempt corporations see p. 315], and

(*c*) Incomes derived from the business of life, health, and accident insurance combined in one policy issued on the weekly premium payment plan.

Sec. 202. That the tax shall not be imposed in the case of the trade or business of a foreign corporation or partnership or a non-resident alien individual, the net income of which trade or business during the taxable year is less than $3,000.

Deductions allowed domestic corporations.—Sec. 203. That for the purposes of this title the deduction shall be as follows, except as otherwise in this title provided—

(*a*) In the case of a domestic corporation, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the pre-war period was of the invested capital for the pre-war period (but not less than seven or more than nine per centum of the invested capital for the taxable year), and (2) $3,000;

Deductions allowed domestic partnerships, citizens and residents.—(*b*) In the case of a domestic partnership or of a citizen or resident of the United States, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the pre-war period was of the invested capital for the pre-war period (but not less than seven or more than nine per centum of the invested capital for the taxable year), and (2) $6,000;

Deductions allowed foreign corporations, partnerships and non-resident aliens.—(*c*) In the case of a foreign corporation or partnership or of a non-resident alien individual, an amount ascertained in the same manner as

provided in subdivisions (*a*) and (*b*) without any exemption of $3,000 or $6,000.

Deductions when income of pre-war period cannot satisfactorily be determined.—(*d*) If the Secretary of the Treasury is unable satisfactorily to determine the average amount of the annual net income of the trade or business during the pre-war period, the deduction shall be determined in the same manner as provided in section two hundred and five.

Deductions allowed when corporation or partnership not in existence in pre-war period.—Sec. 204. That if a corporation or partnership was not in existence, or an individual was not engaged in the trade or business, during the whole of any one calendar year during the pre-war period, the deduction shall be an amount equal to eight per centum of the invested capital for the taxable year, plus in the case of a domestic corporation $3,000, and in the case of a domestic partnership or a citizen or resident of the United States $6,000.

Reorganized business considered continuous.—A trade or business carried on by a corporation, partnership, or individual, although formally organized or reorganized on or after January second, nineteen hundred and thirteen, which is substantially a continuation of a trade or business carried on prior to that date, shall, for the purposes of this title, be deemed to have been in existence prior to that date, and the net income and invested capital of its predecessor prior to that date shall be deemed to have been its net income and invested capital.

Deductions allowed when no pre-war income or when percent of pre-war income was low.—Sec. 205. (a) That if the Secretary of the Treasury, upon complaint, finds either (1) that during the pre-war period a domestic corporation or partnership, or a citizen or resident of the United States, had no net income from the trade or business, or (2) that during the pre-war period the per-

centage, which the net income was of the invested capital, was low as compared with the percentage, which the net income during such period of representative corporations, partnerships, and individuals, engaged in a like or similar trade or business, was of their invested capital, then the deduction shall be the sum of (1) an amount equal to the same percentage of its invested capital for the taxable year which the average deduction (determined in the same manner as provided in section two hundred and three, without including the $3,000 or $6,000 therein referred to) for such year of representative corporations, partnerships or individuals, engaged in a like or similar trade or business, is of their average invested capital for such year, plus (2) in the case of a domestic corporation $3,000, and in the case of a domestic partnership or a citizen or resident of the United States $6,000.

The percentage which the net income was of the invested capital in each trade or business shall be determined by the Commissioner of Internal Revenue, in accordance with the regulations prescribed by him, with the approval of the Secretary of the Treasury. In the case of a corporation or partnership which has fixed its own fiscal year, the percentage determined by the calendar year ending during such fiscal year shall be used.

(*b*) The tax shall be assessed upon the basis of the deduction determined as provided in section two hundred and three, but the taxpayer claiming the benefit of this section may at the time of making the return file a claim for abatement of the amount by which the tax so assessed exceeds a tax computed upon the basis of the deduction determined as provided in this section. In such event, collection of the part of the tax covered by such claim for abatement shall not be made until the claim is decided, but if in the judgment of the Commissioner of Internal Revenue the interests of the United States would be jeopardized thereby he may re-

quire the claimant to give a bond in such amount and with such sureties as the Commissioner may think wise, to safeguard such interests, conditioned for the payment of any tax found to be due, with the interest thereon, and if such bond, satisfactory to the Commissioner, is not given within such time as he prescribes, the full amount of tax assessed shall be collected and the amount overpaid, if any, shall upon final decision of the application be refunded as a tax erroneously or illegally collected.

Ascertainment of net income of a corporation for pre-war period.—Sec. 206. That for the purposes of this title the net income of a corporation shall be ascertained and returned

(*a*) for the calendar years nineteen hundred and eleven and nineteen hundred and twelve upon the same basis and in the same manner as provided in section thirty-eight of the Act entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August fifth, nineteen hundred and nine, except that income taxes paid by it within the year imposed by the authority of the United States shall be included;

(*b*) for the calendar year nineteen hundred and thirteen upon the same basis and in the same manner as provided in section II of the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October third, nineteen hundred and thirteen, except that income taxes paid by it within the year imposed by the authority of the United States shall be included, and except that the amounts received by it as dividends upon the stock or from the net earnings of other corporations, joint-stock companies or associations, or insurance companies, subject to the tax imposed by section II of such Act of October third, nineteen hundred and thirteen, shall be deducted; and

(*c*) for the taxable year upon the same basis and in the same manner as provided in Title I of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, as amended by this Act, except that the amounts received by it as dividends upon the stock or from the net earnings of other corporations, joint-stock companies or associations, or insurance companies, subject to the tax imposed by Title I of such Act of September eighth, nineteen hundred and sixteen, shall be deducted.

Ascertainment of net income of a partnership or individual for pre-war period.—The net income of a partnership or individual shall be ascertained and returned for the calendar years nineteen hundred and eleven, nineteen hundred and twelve, and nineteen hundred and thirteen and for the taxable year upon the same basis and in the same manner as provided in Title I of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, except that the credit allowed by subdivision (*b*) of section five of such Act shall be deducted.

There shall be allowed (*a*) in the case of a domestic partnership the same deductions as allowed to individuals in subdivision (*a*) of section five of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act; and

(*b*) in the case of a foreign partnership the same deductions as allowed to individuals in subdivision (*a*) of section six of such Act as amended by this Act.

Definition of "invested capital."—Sec. 207. That as used in this title, the term "invested capital" for any year means the average invested capital for the year, as defined and limited in this title, averaged monthly.

As used in this title "invested capital" does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which

is not subject to the tax imposed by this title, nor money or other property borrowed, and means, subject to the above limitations;

"Invested capital" of a corporation or partnership.—(*a*) In the case of a corporation or partnership: (1) actual cash paid in, (2) actual cash value of tangible property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment (but in case such tangible property was paid in prior to January first, nineteen hundred and fourteen, the actual cash value of such property as of January first, nineteen hundred and fourteen, but in no case to exceed the par value of the original stock or shares specifically issued therefor), and (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year: *Provided,* That (a) the actual cash value of patents and copyrights paid in for stock or shares in such corporation or partnership, at the time of such payment, shall be included as invested capital, but not to exceed the par value of such stock or shares at the time of such payment, and (b) the good will, trade marks, trade brands, the franchise of a corporation or partnership, or other intangible property, shall be included as invested capital if the corporation or partnership made payment bona fide therefor specifically as such in cash or tangible property, the value of such good will, trade mark, trade brand, franchise, or intangible property, not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment; but good will, trade marks, trade brands, franchise of a corporation or partnership, or other intangible property, bona fide purchased, prior to March third, nineteen hundred and seventeen, for and with interests or shares in a partnership or for and with shares in the capital stock of a corporation

(issued prior to March third, nineteen hundred and seventeen), in an amount not to exceed, on March third, nineteen hundred and seventeen, twenty per centum of the total interests or shares in the partnership or of the total shares of the capital stock of the corporation, shall be included in invested capital at a value not to exceed the actual cash value at the time of such purchase, and in case of issue of stock therefor not to exceed the par value of such stock;

"Invested capital" of individual.—(b) In the case of an individual, (1) actual cash paid into the trade or business, and (2) the actual cash value of tangible property paid into the trade or business, other than cash, at the time of such payment (but in case such tangible property was paid in prior to January first, nineteen hundred and fourteen, the actual cash value of such property as of January first, nineteen hundred and fourteen), and (3) the actual cash value of patents, copyrights, good will, trade marks, trade brands, franchises, or other intangible property, paid into the trade or business, at the time of such payment, if payment was made therefor specifically as such in cash or tangible property, not to exceed the actual cash or actual cash value of the tangible property bona fide paid therefor at the time of such payment.

"Invested capital" of foreign corporation or partnership or non-resident alien.—In the case of a foreign corporation or partnership or of a non-resident alien individual the term "invested capital" means that proportion of the entire invested capital, as defined and limited in this title, which the net income from sources within the United States bears to the entire net income.

"Invested capital" in case of reorganization, consolidation or change of ownership.—Sec. 208. That in case of the reorganization, consolidation, or change of ownership of a trade or business after March third, nineteen hundred and seventeen, if an interest or control in

such trade or business of fifty per centum or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in cash or tangible property, and then not to exceed the actual cash or cash value of the tangible property paid therefor at the time of such payment.

Assessment of tax of business having nominal capital.—Sec. 209. That in the case of a trade or business having no invested capital or not more than a nominal capital there shall be levied, assessed, collected, and paid, in addition to the taxes under existing law and under this act, in lieu of the tax imposed by section two hundred and one, a tax equivalent to eight per centum of the net income of such trade or business, in excess of the following deductions: in the case of a domestic corporation, $3,000, and in the case of a domestic partnership or a citizen or resident of the United States, $6,000; in the case of all other trades or business, no deduction.

Deduction when invested capital cannot satisfactorily be determined.—Sec. 210. That if the Secretary of the Treasury is unable in any case satisfactorily to determine the invested capital, the amount of the deduction shall be the sum of (1) an amount equal to the same proportion of the net income of the trade or business received during the taxable year as the proportion which the average deduction (determined in the same manner as provided in section two hundred and three, without including the $3,000 or $6,000 therein referred to) for the same calendar year of representative corpo-

rations, partnerships, and individuals, engaged in a like or similar trade or business, bears to the total net income of the trade or business received by such corporations, partnerships, and individuals, plus (2) in the case of a domestic corporation $3,000, and in the case of a domestic partnership or a citizen or resident of the United States $6,000.

For the purpose of this section the proportion between the deduction and the net income in each trade or business shall be determined by the Commissioner of Internal Revenue in accordance with regulations prescribed by him, with the approval of the Secretary of the Treasury. In the case of a corporation or partnership which has fixed its own fiscal year, the proportion determined for the calendar year ending during such fiscal year shall be used.

Returns to be rendered by partnerships.—Sec. 211. That every foreign partnership having a net income of $3,000 or more for the taxable year, and every domestic partnership having a net income of $6,000 or more for the taxable year, shall render a correct return of the income of the trade or business for the taxable year, setting forth specifically the gross income for such year, and the deductions allowed in this title. Such returns shall be rendered at the same time and in the same manner as is prescribed for income-tax returns under Title I of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act.

Administration of Act.—Sec. 212. That all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal-revenue taxes not heretofore specifically repealed and not inconsistent with the provisions of this title are hereby extended and made applicable to all the provisions of this title and to the tax herein imposed, and all provisions of Title I of

such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, relating to returns and payment of the tax therein imposed, including penalties, are hereby made applicable to the tax imposed by this title.

Regulations.—Sec. 213. That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall make all necessary regulations for carrying out the provisions of this title, and may require any corporation, partnership or individual, subject to the provisions of this title, to furnish him with such facts, data, and information as in his judgment are necessary to collect the tax imposed by this title.

Repeal of excess profits tax law of March 3, 1917.—Sec. 214. That Title II (sections two hundred to two hundred and seven, inclusive) of the Act entitled "An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy, and the extension of fortifications, and for other purposes," approved March third, nineteen hundred and seventeen, is hereby repealed.

Credit for taxes paid under that law.—Any amount heretofore or hereafter paid on account of the tax imposed by such Title II, shall be credited toward the payment of the tax imposed by this title, and if the amount so paid exceeds the amount of such tax the excess shall be refunded as a tax erroneously or illegally collected.

Amendment of Munition Manufacturer's Tax. — Subdivision (1) of section three hundred and one of such Act of September eighth, nineteen hundred and sixteen, is hereby amended so that the rate of tax for the taxable year nineteen hundred and seventeen shall be ten per centum instead of twelve and one-half per centum, as therein provided.

Subdivision (2) of such section is hereby amended to read as follows:

"(2) This section shall cease to be of effect on and after January first, nineteen hundred and eighteen."

TITLE X.—Administrative Provisions.

TITLE XIII.—General Provisions.

Invalidating and repealing clause.—See Sec. 1300.

Approved by the President, October 3, 1917.

CHAPTER XXXIII

EXCESS PROFITS TAX

Importance of Excess Profits Tax.—The tax commonly known as the Excess Profits tax, or more properly the War Excess Profits tax, is really more important than the Income tax. True, it is intended to be a means of getting special revenues to meet war expenses, and is therefore likely to be temporary only. In that respect it is not so important as the Income tax, which will probably in one form or another be used indefinitely to provide revenues to meet the ordinary expenses of running the government. But from the standpoint of the present situation the Excess Profits tax is more important than the Income tax. In the first place, as we have seen, the Excess Profits tax is a new experiment in American taxation practice. In the next place, this tax is likely to yield the government larger revenues than the Income tax. Experts of the Treasury Department and Senate Finance Committee, shortly after the War Revenue Law was enacted, estimated that the Income tax would yield $851,000,000 as against $1,000,000,000 from the Excess Profits tax. While a larger number of individuals and businesses will pay income taxes, the amounts paid by leading industrial concerns on account of the Excess Profits tax will be prodigious compared with the amounts paid for the Income tax. One statistician estimated that the United States Steel Corporation would pay for the year 1917 about $27,000,000 for the Income tax and $150,000,000 for the Excess Profits tax—about a half million dollars for every ordinary working day.

But another, and the most important, reason why the Excess Profits tax outshadows the Income tax is that the former must be ascertained before the latter can be computed. Persons subject to the two taxes are permitted to subtract from their income, in calculating the net income on which they will pay an income tax, sums equal to the amount which they will have to pay for the Excess Profits tax.

General statement as to who is liable.—Liability for this tax will be discussed in detail a little farther along, but in order to save those who may not be concerned with this tax from going any further into this chapter it may be stated here that, in general, returns must be filed, and the tax, if any, be paid only by domestic corporations with incomes of $3,000 a year or more; by domestic partnerships with incomes of $6,000 a year or more; by citizens or residents with incomes in excess of $6,000 a year; and by foreign corporations, foreign partnerships and non-resident alien individuals with a net income of $3,000 a year or more from sources within the United States (Regulations 41, Art. 10, 11, 12).

A married woman who is a sole trader or is entitled to any taxable income to her sole and separate use, may, for purposes of the Excess Profits tax, make a separate return in the same manner as any other individual. (Regulations 41, Art. 76.)

A summary of how the law works.—The reader will get a much better idea of what is to be explained if he will study this paragraph carefully and try to understand the purposes of the Excess Profits Tax law. The explanation of various terms will then seem reasonable and not merely a lot of disconnected rules. Remember, however, that the explanation here given is only of general application; special cases are taken up in detail later.

The Excess Profits Tax of October 3, 1917, is computed in one of two ways, depending upon whether the

trade or business under consideration uses invested capital or does not use invested capital.

Where the trade or business has no invested capital or merely a nominal capital, the tax will be computed at the rate of 8 per cent on the amount of net income in excess of a specific deduction.

Where the trade or business has an invested capital the tax will be computed at graduated rates on the amount of net income in excess of a deduction based in part upon the rate of income for the pre-war period. The same income cannot be taxed on both bases but an individual may be taxed upon different portions of his income on different bases.

Leaving aside the question of the distinction between invested capital and nominal capital, which is discussed elsewhere in this chapter, we must consider the general working of the graduated tax.

A corporation, we will say, had an average invested capital of $100,000 during 1911-1913 and made an average annual profit of $50,000. The rate of profits of this concern during the pre-war period was 50 per cent, but the present law does not say that for present purposes only a rate of profit above 50 per cent for that concern would be excessive, subjecting the concern, therefore, to the War Excess Profits tax; it says, that the maximum rate exempt under any circumstances is 9 per cent, and that any income will be subject to the Excess Profits tax if during the present taxable year it is above 9 per cent of the present invested capital, no matter what the rate of income was in the pre-war period. In any event, then, this concern would be taxed on all income in excess of any amount equal to 9 per cent on its invested capital for the taxable year. (A specific deduction of $3,000 in addition to the 9 per cent on its capital is also allowed.) Having then determined the *rate* of *untaxed* profits for this concern, we turn to its present profits to see what they are. To get the *rate* of profits

we must know the *amount* of profits and the capital on which those profits are being earned. If the present rate is less than 9 per cent the concern will escape the Excess Profits tax, since its pre-war rate was more than 9 per cent, and in such a case 9 per cent will be allowed as a deduction. If, on the other hand, its pre-war profits had been less than 7 per cent, a deduction of only 7 per cent would now be allowed. There are two ways in which the rate may become less than 9 per cent. (1) If, for example, the company had the same net income, $50,000, but if its invested capital had increased to $700,-000, the profits of $50,000 would amount to only about 7 per cent of the invested capital. It therefore is to the interest of the owners of the business to make the present invested capital appear as large as possible, and conversely it is to the interest of the government to limit very carefully the items that can be claimed as invested capital. That, we shall see, is the chief difficulty we shall have to meet in interpreting this law; the difficulty of determining what is and what is not invested capital. (2) Or, if we assume that the capital remained as it was during the pre-war period, viz., $100,000, but the income fell to $7,000, again the rate of profits would fall below the pre-war rate of 9 per cent and the concern would not be taxable. In such a case, however, we would have little difficulty, for the Excess Profits Tax law provides that profits are to be determined by the detailed rules applicable to the Income tax. That, in very brief outline, is the way the law works. Before we examine it in detail, let us summarize the facts that must be determined before the tax can be computed.

GENERAL DEFINITIONS

Before going into a discussion of the application of the law it would be advisable to define some of the terms that will be used throughout this chapter.

Corporation.—"Corporation" is defined as including joint-stock companies or associations and insurance companies and limited partnerships.

United States.—"United States" is defined by the law as "only the States, the Territories of Alaska and Hawaii, and the District of Columbia."

Domestic Corporation. — A domestic corporation is therefore one created under the laws of the United States, or of any State, Territory or District included in the definition above.

Foreign Corporation. — A foreign corporation is one formed under the laws of any other possession of the United States or of any foreign country. Corporations organized in Porto Rico, the Philippines, or the Canal Zone are therefore to be considered "foreign."

Exempt concerns. — Corporations which are exempt from the Income tax are also exempt from the Excess Profits tax. Partnerships carrying on the same business or coming within the same description, and individuals to the extent they carry on or do the same kind of business or come within the same description as that of an exempt corporation are also exempt.

Foreign partnership.—Domestic and foreign partnerships are defined in the same way as are foreign and domestic corporations. It is difficult to decide whether a partnership is organized in the United States or in some foreign country. When, for instance, is a partnership organized or created under the laws, say of England? It may do business both in the United States and in England, and one of its partners may live here and one in England. Moreover, one may have signed a duplicate copy of partnership articles of agreement here, and the other may have signed a duplicate copy in England. Two sets of books may be kept, one here and one in England. The office here may be just as important but no more so than the one in England. What is the test? In the last analysis the Treasury Department

must solve this question. The tendency undoubtedly will be to class such partnerships as domestic.

Pre-war period.—The term pre-war period means the calendar years 1911, 1912, 1913 (the rate of earnings for which period form the bases of the amount of income exempt from the tax), or if the concern was not engaged in trade or business during the whole of such three years, then as many of such years during the whole of which the concern was engaged in trade or business.

Trade or business.—The terms "trade" and "business" are defined to include professions and occupations.

Net income.—The term "net income" as used in reference to foreign corporations or partnerships or non-resident alien individuals means the net income received from sources within the United States.

THE 8 PER CENT TAX

The 8 per cent Excess Profits tax.—As stated before, individuals, partnerships, or corporations engaged in trade or business not employing any invested capital or employing only a nominal capital are subject to a tax at the rate of 8 per cent on their net income in excess of a certain specific deduction. A general statement of those liable to pay the tax is found on page 640.

Income subject to the tax.—The income subject to this tax includes salaries, wages, commissions, bonuses and profits from businesses not employing invested capital. Non-resident aliens, partnerships and corporations are taxed on such portion of their net income as is from sources within the United States. Individuals and partnerships, as explained later, may pay themselves salaries for services rendered, and such salaries would come under this tax.

In the case of a *corporation* or *partnership*, all income from whatever source derived is deemed to be from its trade or business and is therefore subject to the tax

(after deducting $3,000 or $6,000, as the case may be, and income exempt from taxation). In the case of an *individual,* however, only such income is subject to this tax as is derived from

"all his activities for gain, profit or livelihood entered into with sufficient frequency, or occupying such portion of his time or attention as to constitute a vocation, including occupations and professions. When such activities constitute a vocation they shall be construed to be a trade or business whether continuously carried on during the taxable year or not, and all the income arising therefrom shall be included in his return for excess-profits tax.

"In the following cases the gain or income is not subject to excess profits tax, and the capital from which such gain or income is derived shall not be included in 'invested capital': (a) Gains or profits from transactions entered into for profit, but which are isolated, incidental, or so infrequent as not to constitute an occupation, and (b) the income from property arising merely from its ownership, including interest, rent, and similar income from investments except in those cases in which the management of such investments really constitutes a trade or business." (Reg. 41, Art. 8.)

Exempt income.—Fees or compensation received by officers and employees under the United States, or any State, Territory, or the District of Columbia, or any local subdivision thereof, for work as such officers or employees, is exempt. It is held that Congressmen and Senators are not such officers or employees of the United States; their salaries, therefore, are not exempt.

Income exempt from taxation under section 4 of the Income Tax law of 1916 (see page 39) is also exempt.

Income derived from the business of life, health and accident insurance combined in one policy issued on the weekly premium payment plan is exempt.

Specific Exemptions.—Domestic corporations are allowed an exemption of $3,000. Domestic partnerships and individuals are allowed an exemption of $6,000. No exemption is allowed to non-resident alien individuals or to foreign partnerships or corporations.

Importance of determining what is nominal capital.—We saw that the tax was computed in two different ways,

one method being used for concerns with no capital or with only nominal capital, and the other method for concerns with invested capital. Nominal capital is defined as meaning "in general a small or negligible capital whose use in a particular trade or business is incidental." Concerns, therefore, are divided into two classes—Class A being those with no capital or only nominal capital, and Class B being those with "invested capital." This distinction is fundamental, and the taxpayer should determine at the outset whether he belongs to Class A or Class B. Corporations or partnerships must be in one class or the other. Individuals may be in both classes, i.e., they may be required to file two returns, one for one income, to be taxed under Class A, and one for the other income, to be taxed under Class B. Class A concerns pay a flat 8 per cent tax, while the Class B concerns pay the graduated tax.

When does a concern have no capital, or only nominal capital?—The Treasury Regulations make it quite plain that the nature of the business carried on by a concern is the one most important factor in determining whether it belongs to Class A or Class B. Since the Government is likely to derive more revenue from a concern by placing it in Class B than in Class A, the regulations are so framed that doubts as to classification are generally settled by putting the concern in Class B, but the taxpayer will do well to study the rules carefully before coming to a conclusion.

In Class A, it was intended by the law to put concerns that depended chiefly on the personal service and ability of the owners. The mere fact that a concern sells or renders personal service instead of making and selling goods will not bring the concern to Class A unless the earnings of the concern "are to be ascribed primarily to the activities of the owners." A law firm or an accounting firm has nominal capital only, because the reputation of the partners is the chief element of

earnings, and this would seem to be true if the number of employees is many times as great as the number of the partners, and even if the concern is required to maintain a fairly large capital in the form of bank balances to pay salaries and wages. (Reg. 41, Art. 72.) Moreover, if a firm, corporation or individual renders personal services or professional services and employs capital in the form of office furniture, accommodations and equipment, it will not for that reason be taken out of Class A. Nor does the fact that the concern happens to be organized as a corporation affect its status. The chief question to ask, is, are the earnings of the concerns rendering the service such as is being rendered by this concern ordinarily and necessarily procured primarily through the activities of their owners?

Amount of capital employed not a determining factor in classifying concerns.—A firm with large capital, then, may come under Class A while another with small capital may come under Class B. The Regulations say "Business concerns which render *professional or personal service* . . . shall not be taken out of (Class A) because of the size of the capital, if the employment of capital is necessitated by delay or irregularity in the receipt of fees, etc." If the concern is one of the kind that ordinarily falls in Class B, but for some reason its "invested capital," as defined by the law, is "seriously disproportionate to the taxable income," it will, nevertheless, be left in Class B, but it will be treated as "one, the amount of whose invested capital the Secretary of the Treasury cannot determine." (Reg. 41, Art. 52 and 74, and also see pages 689, 693.)

When concerns will be deemed not to have nominal capital.—Some general rules have been laid down for the guidance of concerns, all of which state conditions which may exist without bringing a concern into Class A.

(a) A corporation may, during a taxable year, because of war conditions or because of any other circumstances

have income quite disproportionate to the invested capital. The purpose of the law was to get at precisely that income, and such concerns therefore will not be permitted to claim that they belong in Class A. "In the determination of doubtful cases, stress will be laid upon the normal of net income to capital during pre-war years," and, it may be proper to add, this applies to the relation of income to capital during pre-war years of concerns engaged in the same line of business and not alone to the particular concern in question.

(b) A concern will not be taken out of Class B because its *capitalization* (stocks and bonds of a corporation, or stated capital of a partnership, the liability item of capital invested, not including surplus) is nominal. If they employ a *substantial* capital, that is, if they use a large amount of capital assets, and do not render personal or professional services, they will be taxed in Class B. The excess of capital assets over capitalization, we shall see, may be taken care of by including, under certain restrictions, the surplus in the amount of "invested capital."

(c) The mere fact that a concern, that would otherwise be included in Class B, has invested a large part of its assets in stocks or bonds (other than obligations of the United States) or in other assets the income from which is not subject to the Excess Profits tax, and therefore has but a nominal amount of what is technically defined as "invested capital," does not bring this concern into Class A; it must seek redress by claiming the advantage of the rule in respect to concerns whose capital the Secretary of the Treasury has difficulty in determining. (See page 693, post.)

(d) A concern is not to be put in Class A merely because most of its *capital* was acquired through borrowed funds.

(e) A concern whose original capital was small but has appreciated in value, and whose "invested capital,"

as defined by the law, therefore is relatively small, will not for that reason be taken out of Class B.

(f) A concern with intangible assets "built up or developed by expenditures which have been regularly deducted as items of current expense," will not be permitted to claim that it shall be taxed in Class A, merely because its "invested capital," as the law defines it, is relatively small. For example, a corporation may spend $500,000 a year in advertising, and have an item of good-will easily worth several million — worth several million because it could sell that good-will for that price. This good-will is not included as "invested capital" under the law, because it has not been paid for with stock, cash, or tangible property. (See page 685, *et seq.*)

In cases (d), (e), and (f), while the concern will be classed in Class B, it may still claim the benefit of Section 210 respecting concerns whose capital cannot satisfactorily be established. (Reg. 41, Arts. 52 and 74.)

Brokers and commission merchants.—The Treasury Regulations make a fine distinction between brokers and commission merchants. Technically speaking, the difference between a broker and a commission merchant is rather shadowy. Both sell goods for others, but the broker does not get possession of the goods before the sale, while the commission merchant does get possession. But men frequently term themselves brokers while in fact they sometimes do get possession of the goods before the sale is made. For example, stock brokers are frequently given certificates of stock to sell.

A careful examination of this regulation leads to this conclusion: if a broker uses capital to finance his business operations, he will be deemed to be employing capital and therefore comes in Class B; if, however, he uses capital to finance himself, i.e., to pay salaries of his employees, to pay rent of an office, etc., he will come under Class A. (The Regulation reads: "Agents and brokers requiring and using no capital or merely a nominal cap-

ital in their business are taxable under Class A, but commission houses regularly employing a substantial amount of capital, whether to lend to principals or to carry goods on their own account, are not deemed to be agents or brokers and are taxable under the provisions of Article 16 [relating to Class B]."

Returns Required. — Citizens, and residents of the United States, non-resident aliens, and corporations, both foreign and domestic, are required to make returns of their net income under the provisions of the Income Tax Law. The calculation of this 8 per cent Excess Profits tax will undoubtedly be made on the regular Income Tax form (as in the case of citizens and residents of the United States where the Excess Profits tax is calculated on Form 1040, the standard Income Tax form.) (See footnote, p. 663, post.)

No returns were required of partnerships, either domestic or foreign, under the Income Tax Law, the tax being levied on the individual partners.

For the purposes of the Excess Profits tax, however, a partnership is treated as separate and distinct from its members, and the partnership as such must file a separate return, provided its net income is $6,000 or more if domestic or $3,000 if foreign.

It will be noticed that while foreign partnerships are not given any exemption, they are not required to file a return unless their net income is $3,000 or more. This provision is evidently an error on the part of Congress, as the difference of one cent in the income ($2,999.99 to $3,000) would cost the partnership a tax of $240. Until regulations are issued to the contrary, no returns will be required of non-resident partnerships unless their income is $3,000 or more.

THE GRADUATED EXCESS PROFITS TAX

Who is liable to pay the tax.—An individual or concern, falling within one of the classes mentioned on p.

640, and employing invested capital, is subject to this tax.

It must be remembered that non-resident aliens are liable to the tax only on their income from sources within the United States. The "United States," it must be remembered, for the purpose of this tax, includes, besides the continental territory including Alaska, only Hawaii, so that residents of Porto Rico or the Philippines are to be looked upon as foreigners, and income derived from one of those islands is income derived from outside the United States.

What income is to be included.—Inasmuch as a corporation or partnership is evidently organized for the purpose of engaging in business, all its activities are held to be business. Partnerships and corporations are therefore taxed on their entire net income from all taxable sources. The income of an individual, however, is to be limited, as stated on p. 645.

It will be noticed that the law (sec. 201) provides that wherever a partnership or corporation (not an individual) is engaged in several trades or businesses, all the trades or businesses in which it is engaged "shall be treated as a single trade or business, and all its income from whatever source derived shall be deemed to be received from such trade or business." Its entire income will be held to be subject to the same tax rate; so that if a corporation or partnership employed "invested capital" in one part of its business, and no capital in another part, all its income will be subject to the graduated Excess Profits tax. In the case of an individual, however, the net income may be classified in two groups: Class A, income derived from business or trade employing no invested capital (subject to 8 per cent tax), and Class B, income derived from trade or business having invested capital (subject to the graduated tax). (Reg. 41, Art. 14.) The total income from each class is then reported separately.

Summary of facts to be ascertained before the amount of tax can be determined.—We shall need to ascertain these facts in order to determine the amount of the excess profits tax:

1. The rate of pre-war profits, which necessitates ascertaining

a. pre-war net income.

b. pre-war invested capital on which this income was applied to find the rate of profits.

(Incidentally, it may be mentioned here, it is necessary to determine whether the rate of profits so ascertained is fairly comparable with the rate of profits earned during the same period by other concerns in the same general line of business or whether the rate of the given concern is subnormal. If it is subnormal (i.e., lower by one per cent or more than the normal rate), its own rate of profits is discarded and the normal rate is used in its place. Moreover, if the rate of profits for the pre-war period was less than 7 per cent, 7 per cent will be used as the rate, or if the rate was more than 9 per cent, 9 per cent will be used as the rate.)

2. The net income in the taxable year.

3. The invested capital in the taxable year.

4. The specific exemption to which the taxpayer is entitled.

5. A sum (known as the deduction), found by applying the rate of pre-war profits (see above) to the invested capital of the concern in the taxable year.

The tax then will be applied to the amount of net income in the taxable year, less the deduction and the specific exemption. The rate of tax is based, not on the amount of net income, but on the percentage such net income is of the invested capital.

This method of computing the tax is applicable only where the trade or business has invested capital. Where there is no invested capital, or only a nominal invested

capital, including, in the case of an *individual,* salaries, wages, fees, or other compensations, a flat tax of 8 per cent is levied on the taxable net income in excess of the specific deduction (see page 644).

NET INCOME FOR PRE-WAR PERIOD

Definition—"Taxable year" and "Pre-war period."—The term "taxable year" is clearly defined in the law. For individuals, partnerships and corporations it means the calendar year, excepting in the case of partnerships and corporations which have a fiscal year which does not coincide with the calendar year, in which case the taxable year means the fiscal year. The first taxable year is the year ending December 31, 1917, except in the case of a corporation or partnership which has its own fiscal year, in which case it will be the fiscal year ending during the calendar year 1917. If a corporation or partnership, prior to March 1, 1918, makes a return covering its own fiscal year, and includes therein income received during that part of the fiscal year falling within the calendar year 1916, the tax for the taxable year will be "that proportion of the tax computed upon the net income during such full fiscal year which the time from January 1, 1917, to the end of such fiscal year bears to the full fiscal year."

In order to determine whether a person or corporation may deduct from his income seven or nine per cent (or any percentage between them) of his capital, it is necessary, as we have seen, to ascertain the rate of profits made by such person or corporation during the pre-war period. The law describes the pre-war period as the calendar years 1911-1913 inclusive. But if a corporation or partnership was not in existence or a person was not engaged in a trade or business during the whole of such period, then as many of such years during the whole of which the corporation or partnership was in existence or the individual was engaged in

trade or business will be taken to constitute the pre-war period. What is to be done with corporations, partnerships and individuals that do not come even under this second rule is explained later.

No report of net income for pre-war period required in certain cases.—No report of the net income for the *pre-war period* will be required of either individual, partnership or corporation in the following cases:

(1) If the taxpayer is willing to accept the minimum percentage, i.e., 7 per cent, as the percentage to be used in computing the deduction under section 203 of the law. Therefore, if the taxpayer's pre-war rate of income on his pre-war "invested capital" was 7 per cent or less, he will not make a report of pre-war income and pre-war "invested capital."

(2) If the trade or business has no invested capital, or not more than a nominal invested capital, and is taxable only at the 8 per cent rate under section 209 of the law.

In either of the above cases, however, a return of information as to all facts which may be necessary for the ascertainment of the capital and income for the *taxable year* will be required, except in the case of those who are exempt from the tax.

Net income of citizens or residents for pre-war period.—The intention of the law is to tax the excess profits (of businesses having more than a nominal invested capital) of the present taxable year as compared with the profits of the pre-war period. It is therefore necessary to calculate the pre-war profits on the same basis as the taxable year profits (see pp. 644, 686). If, therefore, in computing the net income for the taxable year an individual deducts a reasonable amount designated as salary (p. 659), he must also, in computing net income for the pre-war period, make a corresponding deduction (Reg. 41, Art. 40).

Net income of individuals for the pre-war period when they were not engaged in trade or business, and in other exceptional cases.—(1) *Where the citizen or resident was not engaged in a trade or business during the pre-war period.*—Where the individual was not in trade or business during the pre-war period (as that period is defined above) the law in effect assumes that during such period the individual's net income was 8 per cent of his invested capital (section 204).

(2) (*a*) *Where the citizen's or resident's income for the pre-war period cannot be satisfactorily determined, or* (*b*) *where pre-war profits were lower by one per cent or more of the net income to the invested capital of representative concerns engaged in a similar trade or business during the same period, or* (*c*) *where he made no profits though he was engaged in business.*—If the Secretary of the Treasury, upon complaint, finds that any of the conditions mentioned in the heading of this paragraph exists then the pre-war rate of profits is to be taken as being the same as that of representative concerns in the same line of business, not, however, less than 7 per cent or more than 9 per cent.

Whether an individual's rate of profits was subnormal or not, is to be ascertained by comparing it with the rate of profits of representative concerns. This means, of course, that sooner or later the Treasury Department will have to determine the average pre-war rate of profits in various lines of business. As this will not be done till after the returns are due, in cases arising under subdivisions (a) or (c), the return will be filed and the tax assessed in the first instance, assuming a 7 per cent pre-war rate of profit; and in cases arising under (b) the return will be filed and the tax assessed in the first instance on the basis of the actual subnormal pre-war rate of profits, but not less than 7 per cent. In any of these cases the taxpayer should file with his return a claim for abatement (Form 47) of

the amount of tax by which the tax so assessed exceeds a tax computed on the basis of the pre-war rate of profits of representative concerns (Law, Section 205, [*b*]). See also p. 698, Claims for abatement.

Perhaps an illustration will make this clear. An individual was in business in 1911-1913 but made no profits. He had continuously invested in his business $100,000 of capital. His income for 1917 was $25,000. He would have to pay the excess profits tax on $25,000 less $7,000 (the minimum deduction being 7 per cent of the invested capital) and less the specific exemption of $6,000. If, however, representative concerns in the same line of business had made 8 per cent during the pre-war period, by "complaining" and filing his claim for abatement along with his return, he would eventually, when the claim was adjusted, pay a tax on $25,000 less 8 per cent and less the specific exemption of $6,000. That is, he would pay a tax on $25,000 less $8,000, less the specific exemption of $6,000. If his capital had been only $50,000, his taxable net income would be $25,000 less $4,000 (i.e., 8 per cent of $50,000) less the specific exemption of $6,000.

Net income for pre-war period of non-resident aliens.—The pre-war rate of profits of non-resident aliens is worked out on the basis of income from sources within the United States only, and is found for non-resident aliens, as it is for citizens or residents. However, non-resident aliens are not entitled to the rule pertaining to businesses having no net income, although in existence during the pre-war period (Case 2 (c), p. 655), but they are entitled to the application of the rule for finding a standard of pre-war profits, in cases (a) and (b), mentioned on p. 655, and where they are not engaged in business or trade during the pre-war period (section 204). In any event, they may take at least 7 per cent instead of the actual pre-war rate of income. (Section 203, subdivision [*c*].)

Pre-war profits of partnerships.—The net income of a partnership for each of the years 1911, 1912 and 1913 is determined in the same manner as the net income for the taxable year. Dividends from stock or from the net earnings of corporations, joint-stock companies, or associations, or insurance companies, subject to the tax imposed by the laws of 1909 or 1913 are to be deducted. Moreover, if salaries of partners (p. 660) and interest (p. 661) are deducted in the taxable year, a corresponding deduction must also be made from net income of the years 1911, 1912, and 1913. (Reg. 41, Art. 34). The other rules for finding the pre-war profits of domestic partnerships are the same as those applying to residents and citizens, while those for foreign partnerships are the same as those for non-resident aliens.

Pre-war profits of domestic corporations.—To find the profits for 1911, the corporation simply refers to its report covering the income for that year under the law of 1909, and adds the tax paid under that law in 1911 on income earned in 1910, as this income tax was subtracted in the report filed in 1911 in arriving at net income. The same process is repeated in finding the profits for 1912. To find the net income for 1913, add to the net income as shown in the return filed in that year the income tax paid within the calendar year 1913 and deduct from the total so obtained the dividends received from corporations, etc., subject to that tax. (Reg. 41, Art. 29.) (The law of 1909 provided that such dividends should be deducted, and hence that matter was taken care of in the reports filed in pursuance of that law.)

Pre-war profits of domestic corporations not in existence before the war.—The same rule applies here as applies to citizens and residents: the pre-war profits are assumed, for the purpose of the law, to be 8 per cent of the capital in the taxable year.

Pre-war profits of domestic corporations, where such profits cannot be satisfactorily determined, or where subnormal or where the corporation, though in existence, made no profits.—What was said on this subject with respect to citizens and residents applies to domestic corporations as well. (See page 655.)

Pre-war profits of foreign corporations.—The pre-war profits of foreign corporations are found in the same way as are those of domestic corporations, except that the examination of the income is restricted to that coming from sources within the United States. As in the case of individuals and partnerships, foreign corporations come under the rule applicable to domestic concerns in cases where such foreign corporations were not in existence during the pre-war period, and to the rules applicable to cases (a) and (b) on p. 655, but they are not entitled to the rule pertaining to claims for abatement of tax where the corporation was in existence in the pre-war period but made no profits. In any case they may, however, take 7 per cent instead of the actual pre-war rate of income, if that is lower.

Pre-war capital.—The capital of the concern during the pre-war period to which the profits are to be applied in order to discover the pre-war *rate* of profits is calculated for that period in the same way that capital is calculated for the taxable year. (See the discussion in the following pages.)

NET INCOME DURING THE TAXABLE YEAR

Net income of individuals.—The net income of an individual employing no invested capital or only nominal capital in his trade or business is determined by selecting from the income tax return for the year those items mentioned on p. 644 under "Income subject to tax."

When there is invested capital employed in the trade or business, the same method is followed, except that from such income there may be deducted a reasonable

salary. (See next paragraph.) Moreover, dividends received from corporations, joint-stock companies or associations, which are subject to the income tax are not subject to this Excess Profits tax. An individual dealing in securities, however, must include (1) the amount of interest received on bonds or obligations of the United States, issued after September 24, 1917, in excess of \$5,000 principal of such bonds or obligations, and (2) the proportion of dividends received upon the stock of foreign corporations which the net income of such corporations from sources outside the United States is of their entire net income. (Reg. 41, Art. 36.)

Contributions to religious and charitable organizations, etc. (see page 113), subject to the limitations there mentioned, may be deducted in computing the net income of the trade or business for the purpose of the Excess Profits tax, providing it is shown to the satisfaction of the Commissioner of Internal Revenue that such contributions are made by the trade or business and not by the individual in his personal capacity. (Reg. 41, Art. 37.)

Deduction of salary by individual employing invested capital.—An individual carrying on a trade or business having an invested capital may, for the purpose of the Excess Profits tax, designate a reasonable amount as salary for services actually rendered by him in the conduct of his trade or business, and he may deduct such salary from the net income of the trade or business, thus making the excess profits for the trade or business smaller. But any such salary is subject to the Excess Profits tax, if any (i.e., if this salary and other salaries received by the individual amount to more than \$6,000), at the 8 per cent rate under Section 209 (Form 1040). The balance of the income in excess of the allowed deductions derived from the trade or business is subject to the graduated rates prescribed in Section 201 (Form 1103). The Treasury Depart-

ment has ruled (T. D. 2611) that "in no case shall the amount of such salary so designated be in excess of the salaries or compensation customarily paid for similar services under like responsibilities by corporations or partnerships engaged in like or similar trades or businesses. In the case of a non-resident alien individual, the amount shall be limited to that portion of the salary or compensation which is for service rendered with respect to trade or business carried on in the United States."

It will appear, therefore, that where an individual conducts a business with "invested capital" he should, for Excess Profits tax purposes, deduct a salary in the following case: Where the net income during the taxable year exceeds the deduction (see page 691) plus the specific exemption (see page 690). The amount of salary to be deducted will depend on the relative size of the individual's salary and the business' excess profits, taking into consideration the higher rates imposed on the latter profits. (The graduated taxes on businesses with invested capital are higher than the tax on salaries at the flat 8 per cent rate.)

Where a person derives income from his interest in a partnership, such income in his hands will not be subject to the Excess Profits tax. This income is treated as income from dividends received from a corporation. Such share of the profits (like dividends of a corporation), distributed or distributable to the individual partner, is not deductible by the partnership in determining its net income for Excess Profits tax purposes. But where the partnership deducts as an expense (for the purpose of the Excess Profits tax) reasonable salaries paid to the individual partners for services actually rendered during the taxable year,[1] the individual partner's salary (including any amount allowed to the partnership as a deduction on his account

[1] See page 661, post.

for the period prior to March 1, 1918) is subject, in the hands of the recipient, to the Excess Profits tax, if any, at the 8 per cent rate under Section 209. (T. D. 2612.)

Net income of partnerships for the taxable year.—The net income of partnerships is figured in the same way as that of individuals (salaries paid to partners and interest paid on loans by partners may be deducted), foreign partnerships for this purpose being treated as non-resident aliens, and domestic partnerships as citizens or residents.

In determining the net income of the partnership, the interest on bonds, etc., of the United States issued after September 24, 1917, in excess of the interest on $5,000 of such bonds, is to be included as income; and dividends received from corporations, etc., subject to the income tax may be deducted. (Reg. 41, Art. 30.) But only that proportion of the dividends received on stock of foreign corporations may be deducted as the net income of such foreign corporation from sources within the United States is of its entire net income. (Reg. 41, Art. 27.)

In computing net income for the purpose of the Excess Profits tax, a partnership will be allowed to deduct as an expense reasonable salaries or compensation paid to individual partners for personal services actually rendered during the taxable year, if the payments are made in accordance with prior agreements and are properly recorded on the books of the partnership. In no case may the salaries or compensation so deducted be in excess of the salaries or compensation customarily paid for similar services under like responsibilities by corporations engaged in like or similar trades or businesses.

With respect to *any period prior to March 1, 1918,* where no previous agreement has been made as to salaries or compensation, a similar deduction will be allowed for services actually rendered.

In the case of a foreign partnership the deduction will be limited to those portions of salaries or compensation which are paid for services rendered with respect to trade or business carried on in the United States. (T. D. 2611.)

A partnership with "invested capital" should, therefore, for the purpose of the Excess Profits tax, deduct and pay salaries (instead of a share of the profits) to partners in the following case: when the net income of the partnership in the taxable year exceeds the deduction (see page 691) and the specific exemption (see page 690). The amount of salary paid (instead of a share in the profits) will depend upon the relative size of the salary of each partner and of the excess profits of the partnership, it being remembered that the graduated rates of tax on excess profits are considerably more than the flat 8 per cent rate imposed on salaries in excess of $6,000.

A partnership may also deduct interest paid to an individual partner on any bona-fide loan, but no deduction for so-called interest on capital will be allowed. (Reg. 41, Art. 33.)

Net income of domestic corporations for the taxable year.—The net income of domestic corporations for the taxable year is found in the same way as that used for income tax purposes, adding to that income the amount, if any, received as interest on bonds or other obligations of the United States, issued after September 1, 1917, in excess of the interest on $5,000 principal of such bonds or obligations, and deducting from the total the dividends received from corporations, etc., subject to the income tax. The rule as to the deduction of dividends on foreign corporations is the same as that found on p. 661.

Net income of foreign corporations for the taxable year.—Foreign corporations figure their net income for the taxable year in the same way that domestic corporations

do, except that they confine themselves to income derived from sources within the United States.

COMPUTATION OF INVESTED CAPITAL

When invested capital must be computed.—Where a concern must make a return and it does not come under the class whose capital is nominal, it becomes necessary for it to compute its invested capital.[1] It must be remembered that its invested capital consists of its assets, which are listed on the assets side of its balance sheet, and which may be classified as follows: (a) cash; (b) tangible property; (c) patents and copyrights; (d) good-will, trade-marks, trade brands and other intangible property.

Tangible and intangible property.—Of the kinds of assets mentioned in the foregoing paragraph, cash and patents and copyrights are self-explanatory. A word about the difference between tangible and intangible property may not be out of place. Intangible property is specifically defined in the law and regulations as "property of a character similar to good-will, trade-marks and trade brands." (In the regulations and in this book the term "intangible property" does not include patents or copyrights.) Possibly other forms are "the going-concern value" of public utilities, organization expenses and the like; but as to these, whether they are to be considered assets at all, or as tangible assets, the Treasury Department says it will make rulings as occasion may demand. The following classes of property, when paid in for stock or shares in a corporation or partnership, will be regarded as tangible property so paid in: stocks, bonds, bills and accounts receivable, notes and leaseholds.

Average invested capital.—The amount of invested capital is not necessarily constant during the entire pre-

[1] Even corporations claiming to have nominal capital only, or claiming that they cannot satisfactorily determine the amount of their invested capital, must fill out Form 1103 as far as practicable to show the facts necessary for action on their claim.

war or taxable year. To determine the invested capital for any year, the law requires that an average amount be ascertained on a monthly basis. The amounts of capital invested in each month of the year are added together and the total divided by twelve. If a change in the capital investment is made during a month, the average amount for that month may be ascertained by multiplying the investment as of the first day by the number of days from the first to the date of change, adding to that amount the product of the new invested capital times the number of days remaining, including the date of change, and dividing the result by the number of days in the month.

The method of averaging invested capital prescribed by Form 1103.—The Regulations (Art. 43) seem to provide the method of averaging the capital just described; it is applied in the solution of the problem on page 685. The form of return, however, requires a different method. Suppose the capital at the beginning of the year is $2,970,000 (see the problem, page 684) and that it is increased on September 15th by $500,000 and decreased on November 10th by $50,000. Form 1103 requires each change to be averaged over the year. Thus the increase was effective for 16 days in September and during the three months of October, November and December, or in all 3 16/30 months. (If September had been a 31-day month the fraction would be 17/31.) $500,000 then is multiplied by 3 16/31 and divided by 12—the number of months in the year. The result, $147,222 2/9 is added to the invested capital at the beginning of the year. In the same way the decrease of $50,000 was effective 1 21/30 months and the average decrease for the year, therefore, was $7,083 1/3. This is subtracted from the invested capital. The net result of the two changes makes the invested capital $3,110,138—the same result as is found on page 685.

Invested capital of foreign corporations or partnerships or non-resident alien individuals.—In the case of foreigners, the Regulations provide that they must figure out their entire invested capital and then for the purpose of calculating the tax take that proportion which their net income from sources within the United States is of the entire net income. (Reg. 41, Art. 48.) Perhaps many such concerns, however, will take refuge in another regulation which says that Section 210 of the law relating to tax on concerns whose capital cannot be determined will apply.

When form of organization has been changed.—The intent of the law is undoubtedly to tax a business as such and to look behind the formal organization in which it may be clothed. If, therefore, a business after January 2, 1913, is substantially the same business as it was on or before that date, though it may change the form of its legal organization after that date, the net income and capital of the predecessor concern prior to January 2, 1913, will be deemed to have been its net income and invested capital for the pre-war period.

Changes of ownership after March 3, 1917.—The law (Sec. 208) makes provision for a special case that may arise where a trade or business may, after March 3, 1917, change ownership by consolidation, reorganization or otherwise, though at least a one-half control of it remains in the control of the same person, corporation, association, partnership, or any of them. In such special cases the following rules will apply in ascertaining the invested capital of the new organization:

1. No asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed in computing the invested capital of such prior trade or business if such asset had not been so received or transferred.

2. By way of exception to the above rule, if the transferred asset was paid for specifically in cash or

tangible property, the value of the asset may be assumed to be the actual cash or cash value of the tangible property paid therefore at the time of such payment. (The meaning of "tangible property" is discussed later.)

INVESTED CAPITAL OF PARTNERSHIPS AND CORPORATIONS

How invested capital of a corporation or partnership is computed.—The invested capital, as we saw, consists of the concern's assets and it would seem that in the last analysis the invested capital cannot be any greater than the value of these.

But it must be remembered that not all the assets a company has at any given moment of time can be called capital. Funds passing in and out are not capital. Besides all of its capital is not "invested" capital. The word "invested" connotes ownership. Congress intended in effect practically to make "invested" capital and *owned* capital synonymous terms. The question then arises, how shall we measure the owned capital of a concern? The law and regulations say that we are to go about this in the ordinary way that any business man would use. We simply take the proprietorship—in the case of corporation the stock plus the surplus, and in the case of partnerships the stated capital plus the surplus, and in the case of individuals the capital account—and make certain adjustments in the accounts representing proprietorship that they may tell the true story of invested capital, as invested capital is defined by the law.

We begin then by turning to the liability side of the concern's balance sheet—and for the present we shall speak of corporations and partnerships only.

We find on the liability side of the balance sheet four classes of liabilities: (a) capital stock of corporations, or nominal capital investment in a partnership. These will be spoken of hereafter, respectively, as stock and shares, the shares being the amounts stated

in the partnership's balance sheet as the amounts contributed by the partners.

(b) Funded indebtedness, the same being the long term bond issues spoken of in some of the Regulations as "permanent indebtedness."

(c) Short term or current liabilities.

(d) Surplus and undivided profits—the difference between the assets and the three other classes of liabilities.

In computing invested capital, every corporation or partnership shall add together its paid-in capital and its paid-in or earned surplus and undivided profits.[1] This is the basis of computation of the invested capital. To find the true invested capital intended by the law, certain adjustments have to be made, and these can be made only by going into the financial history of the concern and finding out how the stock was issued or the circumstances under which the partners' shares were written into the accounts, and how the surplus came to be created. The procedure to be followed is to find out what assets were acquired through the issue of stock and then to adjust the amount of stock and the value of the asset to each other, valuing the assets in each case as prescribed by the Regulations. After all the stock has been examined the surplus account is taken up.

Certain adjustments are made in the surplus account as provided in the regulations and as will be explained hereafter. When the capital account and the surplus account have been thus adjusted, their sum will represent the invested capital, subject, however, to one possible item of increase—a percentage of the funded indebtedness—and to one possible cause for reduction

[1] Reserves, such as those for bad debts, for insurance, for dividend equalization, for working capital and for pensions—in fact, all except the depreciation reserves—consisting of amounts not deductible in the computation of net income under the Income Tax law, may, if properly explained, be included as part of the surplus for the purpose of computing invested capital.

—where the sum thus ascertained exceeds the sum of the admissible assets on the assets side of the balance sheet. The *admissible* assets are all the assets when valued in accordance with the Regulations, except stocks, bonds (other than bonds of the United States), the income from which is not subject to the Excess Profits Tax.

We are now ready to see what adjustments must be made in the capital and surplus accounts.

Adjustment of capital account for intangible property acquired on or subsequent to March 3, 1917.—If in looking through our capital account we find that shares were issued, on or subsequent to March 3, 1917, for good-will, trade-marks or trade brands, the item must be crossed out and the capital account reduced by that amount. On March 3, 1917, the first Excess Profits Tax law was passed and it would have been to the interest of concerns to capitalize good-will and other intangible property by issuing stock or shares therefor. To prevent such wholesale writing up of the capital account, the law provides that intangible property cannot be included if acquired for stock or shares after March 3, 1917. (Sec. 207.) Notice that the item must be crossed out in either case: (a) if the intangible property was acquired on or subsequent to March 3, 1917, and (b) if the stock or shares were issued on or subsequent to March 3, 1917, though the property was acquired prior to that time.

Adjustment of stock or shares issued for intangible property prior to March 3, 1917.—We search through our capital account further to find out if any stock or shares were issued prior to March 3, 1917, for intangible property acquired prior to March 3, 1917. If we find such a case the capital account will have to be adjusted as follows:

a. Find the actual value of the intangible property at the date acquired.

b. Find the par value of the stock or shares issued in payment therefor.

c. Find out the stock or shares outstanding on March 3, 1917, and figure out what 20 per cent of it would be. (Where stock has no par value, we give them the market or book value they had on March 3, 1917.) (Reg. 41, Art. 58.)

Wherever stock has been issued for intangible property in excess of *a*, the amount of capital should be reduced by an amount equal to the excess. Thus, if we find that a trade-mark was worth $50,000 but $100,000 in stock was issued therefor, the stock account is written down to $50,000 and the asset which was carried at $100,000 should also be written down to its actual cash value.

After separate adjustments have been made in this way for each piece of intangible property acquired through the issue of stock or shares, all of the intangible property thus adjusted is added up and the sum is reduced, if necessary, to the 20 per cent of the capital as figured out in *c.* (Reg. 41, Art 57-8.) It is essential to bear in mind that *a, b,* or *c* applies, "whichever is the lowest."

Adjustments for stock or shares issued for patents or copyrights.—We next ascertain, in searching through the capital account in the books of account, if *at any time* stock or shares were issued for patents or copyrights. If so, we must find out the following facts about the transactions:

a. What was their actual cash value at the time they were acquired.

b. What was the par value of the stock or shares issued for them at the time. The capital account, if necessary, is then written down to either *a* or *b*, whichever is lower.

Adjustment of stock or shares issued for tangible property acquired prior to January 1, 1914.—We then go over

the capital account again to see if any stock or shares were issued for tangible property prior to January 1, 1914. If so, we establish the following facts:

a. The actual cash value of the property on January 1, 1914. Probably any reasonable appraisal placed on the property by the taxpayer will be accepted as prima facie evidence of its value on that date, but if necessary the taxpayer may be required to sustain his opinion with other evidence, such as the appraisal of some disinterested authority, statement of assessed value in case of real estate, or the market price on January 1, 1914, if that is a matter of general public information. Notice that the original value at the time it was acquired does not enter into the discussion at all (if the property was acquired prior to January 1, 1914).

b. The par value of the stock or shares issued for the property. The capital account is thus adjusted, if necessary, down to *a* or *b*, whichever is lower.[1]

Adjustment of stock or shares issued for tangible property on or after January 1, 1914.—If stock or shares were issued for tangible property on or after January 1, 1914, the capital account must be adjusted to the actual cash value at the time of payment. (Reg. 41, Art. 55.)

Adjustments for issue of stock or shares for mixed tangible and intangible property.—Where it has been discovered that stock or shares were issued for a lump amount of property, part of which was tangible and part intangible, some difficulty would be experienced in applying the foregoing rules relating to adjustments. In such cases some attempt must be made to separate the property and apportion the stock or shares issued to each class of property. If this is done adjustments can be made in accordance with the rules already given.

[1] In filling out Form 1103 notice that the instructions on the blank referring to Schedule c, item 6, contradict the law and the Regulations (Art. 55). Item (b) in the explanation of Schedule c, item 6, should probably read, "amount of cash paid therefor, or if purchased before January 1, 1914, value on that date."

For separating the property into different classes the following rules are to be applied:

(1) In the absence of satisfactory evidence to the contrary, it will be presumed, in the case of a corporation, that its stock was issued for the following purposes in the order named:

(a) Good-will or other intangible property,

(b) Patents and copyrights, and

(c) Tangible property.

(2) Upon the production by the taxpayer of evidence satisfactory to the Commissioner of Internal Revenue as to the actual values at the date of acquisition of (a) the tangible property and (b) the patents and copyrights, the sum of these two items may be applied against the total par value of the securities issued and the remainder will then be deemed to represent the par value of the securities issued for the good-will or other intangible property.

It may be that so much mixed property was acquired for stocks and shares that the whole calculation of invested capital is thrown out on account of the inability of the Secretary of the Treasury to determine satisfactorily the respective values of the several classes of property at the time of payment. In such cases it may be necessary to abandon the attempt to fix the amount of invested capital and to calculate the tax as provided by the law for cases where it is impossible to calculate the invested capital. This subject is discussed at length later.

Adjustments where stock has been returned to the corporation by way of gift.—Frequently, in order to get around the State laws requiring that stock must not be sold at less than par, the promoters of a company will issue to themselves all of the stock of the company for a mine, or for good-will, or a patent, or other property of uncertain value. A value will be placed on the property equal to the capital stock issued and

the stock will be called full-paid. In order to get cash, the promoters will then donate a large part of their stock back to the corporation and since this has been paid for in full it may be issued at any price. It may be sold, say, for $75 a share, although the par value is $100. If, in searching through the capital account, such a situation as this is discovered, the original transaction as far as the donated stock is concerned will be disregarded and the stock account will be adjusted in accordance with the rules above given just as though the second issue had been the original issue.

Adjustment of surplus account for tangible property paid in for stock or shares substantially below their par value.—It may be found in going through the capital account that stock was issued, say, up to $100,000 for tangible property worth $150,000. If the transaction was entered on the books by debiting the property account with $150,000 and crediting the stock account with $100,000 and the surplus account with $50,000, apparently no further adjustment need be made. But the property account may have been debited only with $100,000 and the surplus account credited with nothing. In such a case the following rule would apply: Where it can be shown by evidence satisfactory to the Commissioner of Internal Revenue that tangible property has been conveyed to a corporation or partnership by gift or at a value accurately ascertainable or definitely known as at the date of conveyance, clearly and substantially in excess of the cash or the par value of the stock or shares paid therefor, then the amount of the excess will be classed as paid in surplus, and may be added to the surplus account.

Another example of how this rule works may be helpful. Suppose a company is offered a factory site and a factory building if it will locate its plant in a certain town. The offer is accepted, the property is occupied, and the company enters the transaction on its books.

It would be justified in adding to its surplus (and placing "real estate and plant" on its asset side of its balance sheet) an amount equal to the ascertainable or definitely known value of the plant or real estate at the time it was acquired.

What is meant by the expression "ascertainable or definitely known" is clearly indicated by an example given in the Regulations. Suppose a concern had been given a plot of land as a subsidy to enable it to develop a demand for its services by colonization of the donated land, and that it transpired *subsequently* that the land was very valuable for the ores it contained. If the value of the land had not been added to surplus at all, the only amount that now could be added would be the value of the land which it had for colonization purposes.

How can it be established, to revert to the example first given in this section, that the property which at the time was entered on the books at $100,000 was really worth $150,000? The Regulations say as to this: "Evidence tending to support a claim for a paid-in surplus under these circumstances must be as of the date of conveyance, and may consist, *among other things*, of (1) an appraisal of the property by disinterested authorities, (2) assessed value in the case of real estate, and (3) the market price in excess of the par value of the stock or shares." (Reg. 41, Art. 63.)

Adjustment of surplus account—additions for tangible property.—The concern may be able to show that it has really been using capital assets that have never appeared on the books as such. For example, in 1910 it may have bought 100 typewriters and charged them to expense. These may now be added as assets and an equivalent amount added to the surplus, subject, however, to the following restrictions:

1. They must be *tangible* property.

2. They must have a life extending substantially beyond the year in which the expenditure was made.

3. They must have been charged as current expense.

4. They must still be owned and be in actual use by the taxpayer during the taxable year.

5. They must have been acquired prior to March 1, 1913, or

6. If acquired after March 1, 1913, they cannot be included if their cost was included in the Income Tax return for the year in which they were acquired as items of expense deductible from gross income in computing the net taxable income.

These special rules are applicable to special tools, patterns and similar assets:

1. Their value may not be added to surplus if that value "has been recorded through having been included in the price of goods."

2. If their cost has not been included in the price of goods, and they are held for *only occasional* use, they shall not be assigned a value in excess of the fair value based upon the earnings actually arising from their current use.

3. If such assets are not used currently or occasionally, they may be included only at scrap value.

Remember that none of these adjustments need be made if the assets were originally charged to the capital account. The rules apply only when assets have been improperly charged to the expense account. Wherever an adjustment is found necessary, the burden of establishing the fact that the assets were charged to expense is on the taxpayer and in his return he must make a statement of the proposed additions, specifying the kinds and amount of property involved, the years in which the expenditures were made, and the method followed in distinguishing between capital outlays and current expenses. (Reg. 41, Art. 64.)

Adjustments not allowed for good-will, etc., acquired through expense items.—For ten years a concern may have spent a budget of $500,000 per year on advertising its trade-marked product. The trade-mark thus acquired would probably be worth thousands of dollars. If all or a part of the amounts expended were charged to capital, an asset good-will or trade-mark being placed on the asset side, say with a value at $5,000,000 and an equivalent amount were added to surplus, it would seem that this would be allowed to stand, since the Regulations made no specific direction for the reduction of surplus even though the asset was paid for in cash—not specifically spent for good-will, but indirectly for good-will by buying advertising space. It must be confessed that this is somewhat contrary to a strict reading of the law, but is in accord with the spirit of the Regulations. Perhaps the safe method would be to make no adjustment in a case of this kind, but to leave the matter to the decisions of the collector in each specific case. (See later the discussion on appreciation.)

Suppose, however, none of the advertising budget was charged to capital, but was all charged to expense. In such a case the concern cannot readjust its capital account by adding good-will to assets and an equivalent amount to surplus. The Regulations are specific; they insist upon a literal compliance with the law. The assets cannot be added unless the good-will was specifically paid for as such. If, for example, this same good-will was sold to another corporation for stock prior to March 3, 1917, that other corporation could include the asset at its true value or at the par value of the stock issued for it, whichever was lower. In the hands of the original corporation the good-will cannot be included in the invested capital by being written into capital account. Where, in a case like this, a concern through ultra-conservative accounting has kept good-

will off its books, it may apply for redress under Section 210 of the law. (Reg. 41, Art. 52.)

Suppose, now, another corporation did buy this good-will for, say, $1,000,000, back in 1900, and had written it off $100,000 a year till in 1910 it had disappeared as an asset. The company could reconstruct its surplus account, as far as this item is concerned, and could add $1,000,000 to its surplus and an equivalent amount to its asset item, good-will.

Adjustments in accounts of concerns that have gone through some form of reorganization.—Adjustments can be made as hereinbefore provided, using the books of a predecessor concern in calculating the invested capital for the pre-war period if the present concern is a reorganization of the predecessor, which took the place of the old concern after January 2, 1913, and if the present business is substantially a continuation of the old business. Adjustments of the invested capital for the taxable year should also be made to comply with Section 208 of the law with respect to reorganization, etc., after March 3, 1917. Study Sections 204 and 208 of the law and the Regulations, Arts. 49-50.

Adjustments of surplus on account of appreciation taken up.—Another adjustment of surplus is provided for by the Regulations for appreciation of assets that has been taken up on the books with a consequent increase in surplus. If tangible property has appreciated and the appreciation has been written up on the books, the amount of appreciation subsequent to January 1, 1914, should be written off, unless in the income tax return the appreciation was included as taxable income for the purpose of providing a new value for the asset upon which to calculate depreciation. Appreciation of tangible assets up to January 1, 1914, is not to be written off unless the depreciation brings the asset up above the par value of the stock or shares for which it was acquired, and in such a case it should be writ-

ten off to bring the asset down to the par value of the stock.

Appreciation of intangible property is not permitted by the Income Tax law, and since under the Income Tax law good-will, for example, cannot be appreciated in such a way as to make the appreciation an item of income subject to the tax, it would seem that any appreciation of intangible assets that has taken place, with a consequent inflation of the surplus, would call for an adjustment of the surplus account by subtracting from that account the amount of appreciation.

These adjustments, of course, can only be made after a careful study of the various capital asset accounts.

Adjustments in the surplus account by reason of insufficient allowance for depletion, depreciation and obsolescence.—After the various adjustments described above have been made, another careful survey of the assets must be made to see if any of them are listed in the taxable year at some original value or adjusted value without taking into account losses or expenses sustained from the original organization of the business concern down to the taxable year. For example, if stock had been issued for an automobile purchased in 1913, the value of the automobile at the time it was acquired having been $3,000, and the amount of stock paid therefor $2,500, while its value on January 1, 1914, had fallen to $2,000, under the rules stated above the stock account of $2,500 would have to be reduced to $2,000—the value of the automobile on January 1, 1914. Let us suppose, now, that through a period of four years the asset has depreciated $600 per year. Its true value on January 1, 1917, was $600. If no depreciation had been charged against this asset but it had been kept on the books at its original value of $3,000, under the rule explained above the capital stock would have been reduced from $2,500 to $2,000; now the surplus account would be reduced by an amount equal to the difference between

$2,000, the value of the automobile on January 1, 1914, and $600, the value of the automobile at the beginning of the taxable year. Thus the surplus would be reduced by $1,400 and the asset would be written down to $600.

Amounts added on account of bonded indebtedness.—After all the calculations have been made as above described, the amount of invested capital may be increased in the case of a corporation (not of a partnership) by a certain proportion of the funded indebtedness.[1] This *increase* in the invested capital is not permissible under any section of the law, but is permitted by the Regulations (Art. 44), almost, if not quite, contrary to the provision of the law (Section 207), but was provided in the Regulations to bring the law into agreement with the provision of the Income Tax law. The Regulation reads: "A corporation which under the Income Tax law is allowed to deduct only a part of the entire interest paid upon its indebtedness, may include in its invested capital such a proportion of its permanent indebtedness as the amount of interest upon such indebtedness which the corporation is not allowed to deduct is of the total amount of interest paid upon such indebtedness during the taxable year."

Illustration: a corporation has $100,000 of stock and $600,000 of bonds bearing 5 per cent interest. Under the Income Tax law (Section 1207) this company could deduct from its gross income the interest at 5 per cent on its capital stock plus one-half its bonded indebtedness, ie., on $400,000. We can deduct 5 per cent on $400,000 or $20,000 out of $30,000 of interest actually paid. Since one-third of its interest is not deductible under the Income Tax, it may add to its invested capital one-third of its bonded indebtedness of $600,000, or $200,000.

Adjustments to be made in the assets side of the balance sheet.—We have gone through various adjustments in the liability side of the balance sheet. Each time that an adjustment is made in the capital account or in the

[1] It may, however, be increased in the case of a limited partnership, inasmuch as a limited partnership is subject to the same restriction as to the amount of interest deductible as a corporation.

surplus account, an equivalent adjustment must be made in the asset account to which the capital account or the surplus account corresponds.

For example, if a patent was carried on the books at $100,000 because that amount of stock (par value) had been issued, while the actual cash value was only $50,000, the capital account would be reduced by $50,000 and the patent account by $50,000.

Final adjustment of invested capital as of beginning of year.—A.—We have now (1) a sum obtained by adding adjusted capital, adjusted surplus, and, in the case of a corporation, an allowable proportion of funded indebtedness.

B.—On the assets side, we have adjusted assets, adjusted as described in the preceding paragraphs. (2) These are added up, first *excluding* inadmissible assets. The inadmissible assets are stocks and bonds held by the concern with the exception of United States bonds, and such assets as may not come under the class of either (a) cash, (b) tangible property, (c) patents or copyrights, (d) good-will, trade-marks, trade brands, and other intangible property. Tax-free securities and stocks in foreign corporations may be included as admissible assets to the extent authorized in Articles 45 and 46 of Regulations 41, which provide: "Whenever income consists partly of profits arising from trading in stocks, bonds, etc., the dividends or interest on which are not subject to such tax, and partly of such dividends or interest, then, subject to the limitations as to borrowed money, there shall be included in the invested capital an amount which bears the same ratio to the total amount invested in such stocks or bonds as the amount of such gains or profits bears to the total amount of such income," and "in the case of domestic corporations or partnerships and of citizens or residents of the United States holding stock in a foreign corporation part of whose net income is sub-

ject to the Income Tax, there shall be included in invested capital such proportion of the value of the stock in such foreign corporation as the net income of such foreign corporation from sources outside the United States is of its entire net income." Fictitious items like Bond Discount, for example, would have to be excluded as inadmissible items, since it does not come under Class (a), (b), (c) or (d). There would also have to be subtracted an amount equal to all current liabilities, and an amount equal to that part of all funded or permanent indebtedness, the interest on which is permitted to be deducted from income in ascertaining net income. The result we now have is the sum of the admissible assets.

C.—The total of *invested capital,* as shown in paragraph A, is now compared with the total of *admissible assets,* as shown in paragraph B, and if the invested capital thus shown is larger than the admissible assets, the invested capital must be reduced to the total of the admissible assets. This amount is the invested capital of the concern.

Further adjustments for changes in invested capital during the taxable year.—No adjustment need be made of the invested capital as determined in the preceding paragraphs when the capital stock outstanding has not been changed during the year nor where the surplus account has been neither increased nor decreased. In no case may the invested capital include any surplus or undivided profits earned during the taxable year except in the case of individuals, see page 686. Where capital stock has been increased during the taxable year for the acquisition of assets permitted to be included in invested capital, such capital stock under the Regulations heretofore explained may be added to the invested capital, but the amount of invested capital will have to be averaged over the year. Where the surplus has been reduced during the year, the same rule applies. Illus-

tration: capital stock, $100,000; surplus, $50,000, as of January 1, 1917; earnings up to June 30, 1917, $50,000; on July 1, 1917, a cash dividend of $50,000 was declared as being paid from earnings accrued prior to January 1, 1917; the invested capital in this case would be as follows:

$150,000 × 6 months =	$900,000
100,000 × 6 months =	600,000
12)$1,500,000(	$125,000

The corporation in this case has penalized itself by stating that dividends were paid from 1916 earnings instead of 1917 current profits. If the corporation had declared the dividend from 1917 profits the amount of capital invested for the entire year 1917 would have been $150,000, instead of $125,000. In this particular case, the stockholders receiving the dividend have benefited at the expense of the corporation, since the former under the Income Tax are taxed only at the super-tax rates under the Income Tax law that was in effect for the year 1916 upon such dividends paid.

EXAMPLE OF COMPUTATION OF INVESTED CAPITAL

Balance Sheet, December 31, 1916

(1) Cash	$100,000	Capital Stock	$3,000,000
(2) Real estate, plant and equipment	1,250,000	Bonds	1,000,000
(3) Inventories	50,000	Accounts payable	500,000
(4) Accounts receivable	60,000	Reserves	100,000
(5) Liberty bonds	40,000	Surplus	2,050,000
(6) Stocks	1,000,000		
(7) Patents and copyrights	2,100,000		
(8) Good-will, etc.	2,000,000		
(9) Bond discount	50,000		
Total	$6,650,000	Total	$6,650,000

Capital Stock Adjustments

Item of Adjustment	*Capital Stock issued; for what purpose; nature of adjustment*	*Adjusted amount of Capital stock*	*Asset affected*	*How asset is affected*
I	$1,0000,000 issued Jan. 15, 1915, for trade-mark actually worth $800,000	$800,000	(8)	−$200,000
II	$50,000 issued for a patent proved to be worthless	0	(7)	− 50,000
III	$10,000 issued for plant, then worth $25,000, acquired January 10, 1910. Plant worth $20,000 Jan. 1, 1914. Adjusted to whichever is lower, stock issued or value on Jan. 1, 1914. The difference is treated under adjustment of surplus	10,000	(2)	0
IV	$400,000 issued for $400,000 in cash Feb. 5, 1911; no adjustment necessary	400,000	(1)	0
V	$500,000 issued Sept. 13, 1906, for a plant worth at that time $200,000, but worth $350,000 on Jan. 1, 1914. Value is par value of stock issued or cash value as of Jan. 1, 1914	350,000	(2)	−150,000
VI	$1,000,000 issued for a patent in 1900. $500,000 returned as a gift, and same sold for $300,000. This stock received must be entered at only $300,000	800,000	(7)	−200,000
VII	$40,000 issued July 1, 1913, for Company A's entire assets including furniture and fixtures, goodwill, etc. Company offers evidence to show tangible assets were worth $25,000 on Jan. 1, 1914; rest will be deemed intangible	40,000	....	0
		$2,400,000		
VIII	Adjustment for intangibles purchased with stock*	215,000	(8)	−$215,000
	Total adjusted stock	$2,185,000		

The stock must therefore be written down from $3,000,000 to $2,185,000, and the decrease of $815,000 corresponds with the decrease indicated in the assets of $815,000.

* Regulations 41, Art. 58, provide: "The 20 per cent. limitation upon intangible property purchased prior to March 3, 1917, for or with stock or shares of the corporation or partnership, applies not to each item or class of intangible property separately, but to the aggregate amount of all such property so purchased. Such intangible property may be included in the invested capital only up to an amount not exceeding 20 per cent. of the total stock or shares of the corporation or partnership on March 3, 1917, even though the aggregate amount of such intangible property be greater in value than such 20 per cent. of the par value of the total stock or shares." Here we assume that $815,000 was issued for intangible property (Adjustments VI, VII). Since 20 per cent. of the stock outstanding on March 3, 1917 ($3,000,000) is $600,000 and is less than the $815,000 of intangible property paid for with stock, the adjustment in the example is necessary, the $215,000 subtracted being the difference between the $600,000 (20 per cent. of capital stock outstanding on March 3, 1917) and $815,000, the total of intangibles bought with stock.

Surplus Adjustments

	Nature of adjustment	*Amount of adjustment*	*Corresponding asset affected*	*How affected*
IX	Jan. 10, 1910, stock of $10,000 issued for tangible property worth $25,000, entered on books at $10,000. Value of property on Jan. 1, 1914, $20,000. Since tangible property is to be valued as of Jan. 1, 1914, the difference between $10,000 and the value on Jan. 1, 1914, should be added to surplus.	+$10,000	(2)	+$10,000
X	Sums charged to expense prior to March 1, 1913, for furniture and fixtures, tools, etc., still in existence. Original cost $60,000, less depreciation of $40,000 equals $20,000	+20,000	(2)	+20,000
XI	Jan. 12, 1916, good-will was written up $35,000. This appreciation must be deducted	−35,000	(8)	−35,000
XII	On July 1, 1917, stock held by company was reappraised and written up by the sum of $200,000. This amount of appreciation must be written off, since it could not be entered as income in the calculation of net income	−200,000	(6)	−200,000
XIII	A reserve for $100,000 was set up, but upon examination it is found that all assets are carried at original value. A careful examination shows that an additional deduction of $150,000 should be made to bring the assets to their true value. This calculation is made by a careful consideration of the various asset accounts	−150,000	(2) (7)	−50,000 −100,000
XIV	Certain of the accounts receivable, amounting to $10,000, are discovered to be outlawed	−10,000	(4)	−10,000
XV	It was discovered that an uninsured building was destroyed by fire and that no charge was made in the books to cover the loss. The building was carried on the books at $50,000	−50,000	(2)	−50,000
	Net change in surplus	−$415,000		
	Surplus as adjusted	$1,635,000		

Final Adjustments

Invested capital	
Adjusted capital stock...	$2,185,000
Adjusted surplus.......	1,635,000
Add proportion of the bonded indebtedness, if necessary. The bonds pay 5%. Since the interest on the bonds, $50,000, is less than the interest on the stock plus one-half the bonded indebtedness, no part of the bonded indebtedness may be added	0
Total invested capital.	$3,820,000

Adjusted assets and items of adjustment affecting the asset		*Adjustment amounts*
(1) Cash, I............		$100,000
(2) Real estate, etc..... V, IX, X, XIII, XV.		1,030,000
(3) Inventories.........		50,000
(4) Accounts receivable, XIV..............		50,000
(5) Liberty bonds......		40,000
(6) Stocks, XII........		800,000
(7) Patents, VI, XII....		1,750,000
(8) Good-will, II, VIII, XI................		1,550,000
(9) Bond discount......		50,000
Total............		$5,420,000
Subtract:		
Stocks......	$800,000	
Bond discount (fictitious)	50,000	
Amount of indebtedness, including all current debts, reserves and all funded debts except that added in other column, which in this case happens to be nothing......	1,600,000	
		2,450,000
Admissible assets as adjusted......................		$2,970,000

Since the invested capital as calculated in the left-hand column is greater than the adjusted admissible assets, the invested capital will have to be reduced to the amount of the adjusted admissible assets, and the invested capital of this concern, therefore, at the beginning of the year, will be $2,970,000.

Certain adjustments may have to be made for changes in capital during the year. Let us assume that on June 1, 1917, $250,000 additional capital stock was issued for a trade-mark, on Sept. 15, 1917, $500,000 of additional stock was issued for real estate reasonably worth that much, and that on Nov. 10, a dividend of $50,000 was paid and that this dividend was stated to be paid from earnings of 1916. No adjustment is necessary for surplus or undivided profits earned during the year (Reg. 41, Art. 47). Since the $250,000 of capital stock was issued for intangible property after March 3, 1917, it may be disregarded entirely. The $500,000 issued for real estate will have to be added, and the $50,000 taken out of capital surplus instead of current earnings will have to be subtracted. The company, therefore, had $2,970,000 of invested capital up to Sept. 15. From that date to Nov. 10, it had invested capital of $3,470,000, and from Nov. 10 to the end of the year its invested capital was $3,420,000. The company, therefore, will have to average its

capital monthly over the year as follows, and will have to attach to its return a balance sheet as of Jan. 1, 1917, and as of Dec. 31, 1917.

January	$2,970,000
February	2,970,000
March	2,970,000
April	2,970,000
May	2,970,000
June	2,970,000
July	2,970,000
August	2,970,000
September	3,236,667
October	3,470,000
November	3,435,000
December	3,420,000
	12)$37,321,667
	$3,110,138 Invested capital for the year.

Computation for September:	$2,970,000 x 14—	$41,580,000
	$3,470,000 x 16—	55,520,000
		30) $97,100,000
		$3,236,667
Computation for November:	$3,470,000 x 9—	$31,230,000
	$3,420,000 x 21—	71,820,000
		30)103,050,000
		$3,435,000

INVESTED CAPITAL OF INDIVIDUALS

Items to be included.—The Treasury Regulations provide that the invested capital of an individual shall be measured by the total of the following items:

(a) Actual cash paid into the trade or business;

(b) Tangible property paid into the trade or business;

(c) Intangible property, such as patents and copyrights, and good-will, trade-marks, trade brands and franchises. (Reg. 41, Art. 66.)

Valuation of tangible property.—If purchased in cash, tangible property must be valued at the cost at the time purchased. If the cost is not accurately known, it should be estimated. (Reg. 41, Art. 67.)

If, however, the tangible property was "paid in as such," i.e., was received by the individual in lieu of cash, prior to January 1, 1914, the property must be valued

at its actual cash value on January 1, 1914. "Adequate evidence of such value must be furnished by the taxpayer."

If the tangible property was paid in on or after January 1, 1914, the actual cash value at the time of payment will govern.

"It will be presumed that the tangible assets employed in the trade or business have been acquired with cash, which has been either paid in directly or derived from earnings of the trade or business; but the taxpayer will be entitled to show such assets were paid in as tangible property." (Reg. 41, Art. 67.)

Depreciation of tangible property.—The same general rules apply to the depreciation of the tangible property of an individual as have been previously explained in the determination of the "invested capital" of corporations and partnerships. (See page 677, ante.)

Valuation of intangible property.—Intangible assets of an individual, such as patents and copyrights, and goodwill, trade-marks, trade brands and franchises, "may be included in invested capital at a value not to exceed the actual cash paid therefor as the actual cash value at the time of payment of the tangible property paid therefor, but only if bona-fide payment was made therefor *specifically as such* in cash or tangible property." (Reg. 41, Art. 68.) The italics are the writer's, to bring out the important part of the regulation. Payment must have been made specifically for the intangible property, and not for another account, such as advertising or expense. It is interesting to note that the 20 per cent limitation placed upon the value of the intangible assets of a corporation or partnership in the computation of its "invested capital" does not apply to individuals.

Profits earned during taxable year.—We have seen that corporations and partnerships are not permitted to include as invested capital any profits earned during the taxable year. Individuals, however, may do so.

The profits of the taxable year remaining in the trade or business are considered to have arisen ratably during the year. The amount of these earnings that may be included in the invested capital is the total amount of such earnings averaged monthly over the year. To illustrate: the undivided profits of an individual earned during a taxable year and remaining in the business at the close of that year amount to $24,000. The Regulations assume that this has been earned ratably during the year; in other words, that $2,000 of it was earned during the first month, $2,000 during the second month, $2,000 during the third month, etc. The amounts of such earnings would therefore be as follows at the end of each month:

First month	$2,000
Second month	4,000
Third month	6,000
Fourth month	8,000
Fifth month	10,000
Sixth month	12,000
Seventh month	14,000
Eighth month	16,000
Ninth month	18,000
Tenth month	20,000
Eleventh month	22,000
Twelfth month	24,000

12)$156,000($13,000

The average amount is therefore $13,000, which may be included by the individual in his invested capital. A simpler method of determining this amount is to add the ratable amount for first month, $2,000, to the total for the twelve months, $24,000, and divide the result, $26,000, by two, since the average of any arithmetic progression is one-half the sum of the first and last numbers.

Computation of invested capital.—Two methods for determining the invested capital of an individual are prescribed, the choice of which is dependent upon whether or not the individual keeps books of account.

If the individual does keep such books, the amount of his invested capital appears in the capital account (proprietorship or whatever it may be called). This amount is subject to the adjustments previously mentioned, and must not exceed the total of the admissible assets on the books of the individual. Otherwise the invested capital must be the amount of such assets. Admissible assets have been explained previously under the invested capital computations of corporations and partnerships.

If the individual does not keep books of account "he should prepare and preserve a statement as at the beginning of the taxable year and as the end of the taxable year, showing in full all his assets valued in accordance with these regulations (see page 663, ante), and all his liabilities. The excess of such assets over such liabilities at the beginning of the year and again at the end of the year will constitute the invested capital of the individual on those dates, respectively, provided, that in each case the assets other than those not allowed to be included, equal or exceed the amount of such excess. Otherwise, the invested capital shall be the amount of such assets.

"The amount of the difference between the capital thus shown as at the beginning of the year and at the end of the year will, in the absence of evidence to the contrary, be deemed to have arisen ratably during the year, and the capital at the beginning of the year will be increased or decreased, as the case may be, by such amount averaged monthly over the year." (See page 663, ante.)

Individual engaged in more than one business.—If an individual is engaged in more than one trade or busi-

ness having invested capital, his total invested capital will be considered as being the total invested capital of all the businesses. This applies apparently to an individual solely interested in more than one business, and under such a condition he makes a single return in Class B. The average individual who may be interested in more than one business, one having a nominal capital or no capital at all, would probably come in both Class A and Class B. The income from his principal business would be determined as explained under Net Income of Individuals, and his invested capital in the business would be determined as just explained, and the return would come in Class B. The income from his other interests would be probably reportable under Class A. (See page 645, *et seq.*)

Assets and liabilities of individual restricted.—The term "assets" and "liabilities," as applied to an individual under the Excess Profits Tax law, relate only to the assets and liabilities of his trade or business, and not to his personal assets and liabilities. (Reg. 41, Art. 70.)

When invested capital will be deemed indeterminable.—In certain cases, the law and regulations provide that invested capital, as calculated under the law, shall not be considered the invested capital of the concern, but the Secretary of the Treasury may decide that the invested capital cannot be determined. The Regulations give a number of instances where such cases may arise.

1. Where, through defective accounting or the lack of adequate data, it is impossible accurately to compute the invested capital.

2. Where, upon application by a foreign taxpayer, the Secretary of the Treasury finds that the expense of securing the data necessary for the computation of the invested capital would be unreasonable in view of the amount of the tax involved, or that it is impracticable to determine either the "entire invested capital" or the "entire net income."

3. Where long-established concerns have practised ultra-conservative accounting, and have charged items to expense, such as the cost of trade-marks, advertising expenditures, and the like, and therefore have a small good-will account as compared with representative concerns that have made liberal charges against capital for these items, the ultra-conservative concerns are likely to be placed at a serious disadvantage and may therefore claim the benefit of the rule applying to concerns whose invested capital cannot be determined.

4. Where the invested capital is seriously disproportionate to the taxable income. Such cases may arise through:

(*a*) The realization in one year of the earnings of capital unproductively invested through a period of years or of the fruits of activities antedating the taxable year; or,

(*b*) Inability to recognize or properly to allow for amortization, obsolescence, or exceptional depreciation due to the present war, or to the necessity in connection with the present war, of providing a plant which will not be wanted for the purpose of the trade or business after the termination of the war.

DETERMINATION OF THE AMOUNT OF THE GRADUATED TAX

Summary.—We can assume now that the following facts have been determined: (1) the pre-war income; (2) the pre-war capital; (3) the net income of the taxable year, and (4) the invested capital in the taxable year. From these we can determine (5) the pre-war *rate* of profits, and (6) the *rate* of profits in the taxable year.

To find the tax to which a corporation or foreign partnership is liable, we must find what its "specific exemption" is and what its "deduction" is.

Specific exemptions.—The specific exemptions are as follows: domestic corporations, $3,000; domestic partner-

ships, residents or citizens, $6,000. Foreign corporations and partnerships and non-resident aliens are not entitled to any specific exemptions.

Deductions — in ordinary cases. — In ordinary cases, where the corporation or partnership has been in existence or where the individual has been engaged in business or trade during the pre-war period, the deduction will be that percentage of the invested capital in the taxable year which is determined by dividing the pre-war profits by the pre-war invested capital. In no case, however, may this percentage be less than 7 per cent or more than 9 per cent.

Example: Pre-war profits, $10,000; pre-war capital, $100,000; taxable year profits, $50,000; taxable year capital, $200,000. Deduction: 9 per cent of $200,000 (since the pre-war rate of profits was 10 per cent, the deduction rate will be the maximum, 9 per cent). If in the foregoing example the pre-war profits had been $6,000, the deduction would be 7 per cent of $200,000, since the pre-war rate would be 6 per cent, and the law states the minimum to be 7 per cent. Notice that the pre-war capital and the pre-war profits are to be taken as a whole. Thus, if in the years 1911, 1912, and 1913, the capital was $100,000, $200,000 and $300,000 respectively, and the pre-war profits were $10,000, $20,000 and $60,000, the rate of profits for the pre-war period would be ($100,000 + $200,000 + $300,000) ÷ 3 = $200,-000, divided into $10,000 + $20,000 + $60,000 ÷ 3 = $30,-000, giving 15 per cent. Some people may possibly assume that the rate of profits would be the average of the rates for each of the three years, i.e., 10% + 10% + 20% ÷ 3 = 13⅓%. That method of finding the pre-war rate of profits clearly is wrong.

Deductions where corporation or partnership was not in existence or individual not in business during the pre-war period.—In cases where the concern was not in exist-

ence as such the deduction will consist of 8 per cent of the invested capital in the taxable year.

Example: A corporation was organized in 1915. Its invested capital in 1917 was $100,000. Its deduction would be $8,000.

Notice that if this corporation was a reorganization of a company organized in 1910, and remained substantially in the control of the same interests, the latter's invested capital during 1911, 1912 and 1913 and its profits during those years would determine the percentage of the invested capital to be taken as a deduction. (Section 204.)

Deductions where a concern has no income or subnormal income during the pre-war period.—What is subnormal income is for the Secretary of the Treasury to determine in each case after due consideration has been given to the earnings of the given corporation and to the earnings of representative concerns engaged in the same line of business. The deduction in the return will be figured out in the ordinary way, but a claim will be made for abatement and filed with the return.

Two questions arise here: (1) when are earnings subnormal? (2) what are the earnings of representative firms? Both of these questions, in fact, hinge on the question, what is normal for the general run of concerns engaged in the same line of business? In the final analysis the question will be determined by the Commissioner of Internal Revenue, who, in accordance with regulations prescribed by him, and with the approval of the Secretary of the Treasury, is to determine the percentage which the net income was of the invested capital in each trade or business.

Example: Company *A* had an invested capital of $1,000,000 and net earnings of $60,000 during the prewar period. It happened that ordinarily its earnings are more than 6 per cent of its capital and that other concerns in the same line of business made above 9 per

cent on their invested capital during the pre-war period. *A* would file its return in the usual way, but would file a claim for abatement, asking that its tax be fixed on the basis of a 9 per cent deduction instead of a 7 per cent deduction.

Deduction where the Secretary of the Treasury cannot satisfactorily determine invested capital.—Provision is made for cases where the government cannot satisfactorily determine the invested capital of a given concern. In such cases the deduction shall be an amount equal to the same proportion of the net income of the trade or business received during the taxable year as the average deduction (decided in the same manner as was described in the foregoing section) for the same calendar year of representative concerns engaged in the same business bears to the total net income of the business received by such concerns. Where a corporation or partnership uses a fiscal year of its own, the basis of the deduction shall be the same as though its fiscal year had been the calendar year which terminated in its fiscal year.

Example: Company *A* has a fiscal year ending June 30, 1917. Its capital cannot satisfactorily be ascertained. The deduction will be that proportion of its net income as was found for the calendar year ending December 31, 1916, in representative concerns in the same line of business by dividing their deduction by their net income.

Rate of tax.—The rate of tax is graduated, and the tax itself is found for concerns with invested capital subject to the conditions described in the foregoing sections on deductions, in the following manner: (1) Divide the net income in the taxable year into different classes or brackets. the first bracket being all the net income up to and including 15 per cent of the invested capital; (2) all the net income in excess of 15 per cent of the capital and not in excess of 20 per cent of the

capital; (3) all the net income in excess of 20 per cent and not in excess of 25 per cent of the capital; (4) all the net income in excess of 25 per cent and not in excess of 33 per cent of the capital; and (5) all the net income in excess of 33 per cent.

After these brackets have been computed the deduction and exemption are subtracted first from the first bracket, and if the deduction plus the exemption is greater than the first bracket, nothing further is done about that bracket, but the difference between the deduction plus the exemption and the amount of the first bracket is subtracted from the second bracket and so on till the deduction plus the exemption has been exhausted. Whatever remains in each bracket after this has been done is then taxed at the following rates: for the first bracket, 20 per cent; second, 25 per cent; third, 35 per cent; fourth, 45 per cent; and fifth, 60 per cent.

Example: Company *A's* pre-war rate of profits was 10 per cent; the invested capital for the taxable year was $24,000 and the net income for the taxable year was $25,000. *A's* deduction would be $2,160 (9 per cent of $24,000) and its specific exemption (*A* being a domestic corporation), $3,000.

Bracket No.	Am't. in Bracket	Deduction and Exemption applicable to Bracket	Amount Taxable	Rate	Amount Tax
1	$3,600	$3,600	0	20%	0
2	1,200	1,200	0	25	0
3	1,200	360	840	35	294
4	1,920		1,920	45	864
5	17,080		17,080	60	10,248
Total	$25,000	$5,160	$19,840		$11,406

The return covering trade or business with invested capital will be made on Forms 1101, 1102 and 1103.

Computation of tax for fiscal year, part of which falls in 1916.—If a corporation or partnership makes a return for a fiscal year part of which falls within the calendar year 1916, the tax for the first taxable year is that pro-

portion of the tax computed upon the net income for such fiscal year which the number of months from January 1, 1917, to the end of such fiscal year bears to the entire number of months in such fiscal year. (Reg. 41, Art. 19.)

Computation of tax for period less than 12 months.—If a corporation or partnership makes a return for any reason for a period of less than 12 months, the deduction and exemption allowed will be an amount which bears the same ratio to the deduction allowable for a full year as the number of months in such period bears to 12 months.

DETERMINATION OF TAX WHERE INVESTED CAPITAL IS NOMINAL OR WHERE THERE IS NO INVESTED CAPITAL

Rate of tax in cases without capital.—Where a concern without invested capital or with nominal capital only, or an individual engaged in an occupation or profession without capital, comes under the rules already given for determining who is subject to the tax (e.g., domestic corporations with incomes of $3,000 and citizens with incomes of $6,000, etc.), the rate of tax is 8 per cent, and it is imposed on the net income for the tax year in excess of $3,000 in the case of domestic corporations, and in excess of $6,000 in the case of domestic partnerships and citizens and residents. The rate of tax on foreign corporations and partnerships and nonresident aliens is 8 per cent on the entire net income, from sources within the United States. However, inasmuch as foreign partnerships are not required to file a return unless their net income is $3,000 or more (Sec. 211), it appears that no tax will be paid by a foreign partnership having a net income of $2,999.99.

Example: *M*, a citizen or resident, owns a store with an invested capital of $10,000, the net income of which is $9,000. He also owns a farm, employing a capital of $12,000, the net income of which is $7,000. He also receives a salary of $4,000 as president of a bank, and $3,000 as special counsel. Assume that in the businesses employing capital he is entitled

to the maximum deduction of 9 per cent. *M* allows himself a salary of $3,000 for managing the store and $2,500 for managing the farm. *M* also receives $1,000 in dividends. This $1,000 is not taxable, as it is derived from an investment not connected with his trade. *M* will make out two returns, (a) for income from salaries and compensation from services, and (b) for income from trade or business employing invested capital. In (a) he would include the $4,000 salary, the $3,000 fees and the $3,000 and $2,500 salaries, making a total of $12,500. This may be reported on Form 1040. The excess profits tax will be 8 per cent of $6,500 ($12,500—$6,000, the specific exemption), or $520. The (b) income will be reported on Form 1101. *M* will report on this form a net income of $6,000 from store ($9,000—$3,000 salary), and $4,500 from farm ($7,000—$2,500 salary), total $10,500. From this is deducted a specific exemption of $6,000 and the deduction of $1,980 (9 per cent on $22,000, i.e., $10,000 capital in store plus $12,000 capital in farm). The balance, $2,520, is taxable at the graduated rates mentioned on p. 683.

ADMINISTRATIVE PROVISIONS

When returns are to be filed.—Returns for the Excess Profits tax are due at the same time as those for the Income tax. Upon application to the proper Collector of Internal Revenue returns of corporations and partnerships may be based on a fiscal year other than the calendar year and in such event the returns are due within 60 days after the close of the fiscal year.

Information to be furnished by affiliated corporations.—Reg. 41, Art. 77, provides:

For the purpose of the excess profits tax every corporation will describe in its return all its intercorporate relationships with other corporations with which it is affiliated, and will furnish such information in relation thereto as will enable the Commissioner of Internal Revenue to compute the amount of the tax properly due from each corporation on the basis of an equitable and lawful accounting.

For the purpose of this regulation two or more corporations will be deemed to be affiliated (1) when one such corporation owns directly or controls through closely affiliated interests or by a nominee or nominees, all or substantially all of the stock of the other or others, or when substantially all of the stock of two or more corporations is owned by the same individual or partnership, and both or all of such corporations are engaged in the same or a closely related business; or (2) when one such corporation (a) buys from or sells to another products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or (b) in any way so arranges its financial relationship with another corporation as to assign to it a disproportionate share of net income or invested capital.

Consolidated concerns may be required to make consolidated return.—Reg. 41. Art. 77, provides that:

> Whenever necessary to more equitably determine the invested capital or taxable income, the Commissioner of Internal Revenue may require corporations classed as affiliated under the foregoing rule to furnish a consolidated return of net income and invested capital.
>
> Where such consolidated return is required it may be made by any one or more of such corporations or by all of them acting jointly; but if such affiliated corporations, when requested to file such consolidated returns, neglect or refuse to do so, the Commissioner of Internal Revenue may cause an examination of the books of all such corporations to be made and a consolidated statement to be made from such examination. In cases where consolidated returns are accepted, the total tax will be computed in the first instance as a unit upon the basis of the consolidated return and will be assessed upon the respective affiliated corporations in such proportions as may be agreed among them. If no such agreement is made the tax will be assessed upon each such corporation in accordance with the net income and invested capital properly assignable to it.

When tax is to be paid.—The tax is payable on or before June 15th in each year. Corporations and partnerships filing returns based on a fiscal year instead of the calendar year must pay the tax within 105 days after the return is due.

Credit for taxes under the law of March 3, 1917.—In certain cases, where corporations or partnerships had a fiscal year other than the calendar year reports were made during 1917 under the provision of the Excess Profits Tax law of March 3, 1917, and the amount of the tax assessed and paid. Since that law has been repealed by the law of October 3, 1917, provision was made in the latter law, that amounts so paid shall be credited toward the payment of the tax imposed by the law of October 3, 1917, and if the amount so paid exceeds the amount of the tax, the excess shall be refunded as a tax erroneously or illegally collected.

Partnership tax, how paid and deducted for Income Tax computation.—It will be remembered that partnerships as such pay the Excess Profits tax, but not the Income tax. Since a person paying the Income tax is entitled to subtract the amount of the Excess Profits tax from

income before arriving at the amount of net income taxable under the Income tax law, the partners should calculate the Excess Profits tax for the partnership and each partner should give himself credit for that proportion of the tax in calculating his net income for Income tax purposes as his share in the business bears to the entire proprietorship.

Claims for abatement.—If a taxpayer files a claim for abatement of taxes on Form 47 (see p. 655, *et seq.*), collection of the portion of the tax covered by the claim in abatement will not be made till a decision is rendered on the merits of the claim. If, however, the Commissioner of Internal Revenue deems it advisable, he may require a bond for the payment of the amount withheld as an abatement. If in such cases a bond is demanded and not furnished the full amount of the tax will be required. If, thereafter, the claim is decided favorably to the taxpayer, a refund of the amount will be made.

Penalties.—Since the Excess Profits law provides that all administrative, special and general provisions of law, including the laws in relation to the assessment, remission, collection and refund of internal revenue taxes not inconsistent with this law, as well as those provisions of the Income Tax law applicable to returns and payment, including penalties, are made applicable to the Excess Profits tax, the reader is referred to the chapter on the administration of the Income Tax for explanation of penalties, etc., under this law. (See Chapter II.)

Extension of time for filing returns on basis of fiscal year.—A universal extension of time to April 1, 1918, to file returns has been granted to all corporations and partnerships making returns based on a fiscal year ending during 1917. The law requires returns to be made within 60 days after the fiscal year closes, but this extension has been necessary on account of the delay in issuing the official forms.

WAR EXCESS PROFITS TAX REGULATIONS NO. 41

DEFINITIONS

Article I. Definitions.—When used in these regulations the terms defined in articles 2 to 9, inclusive, shall, unless otherwise indicated by the context, be deemed to be used only with the scope or meaning ascribed to them respectively in such articles.

2. **Corporation.**—The term ''corporation'' includes joint-stock companies or associations, no matter how created or organized, insurance companies, and limited partnerships.

3. **Domestic and foreign.**—The term ''domestic'' means created under the law (statutory or other) of the United States or any State thereof, Alaska, Hawaii, or the District of Columbia, and the term ''foreign'' means created under the law (statutory or other) of any other possession of the United States or of any foreign country or government.

4. **United States.**—The term ''United States'' (when used in a geographical sense) means only the States thereof, Alaska, Hawaii, and the District of Columbia.

5. **Taxable year.**—The term ''taxable year'' means the 12 months ending December 31 of each year, except in the case of a corporation or partnership which has fixed its own fiscal year, in which case it means such fiscal year. The first taxable year is the year ending December 31, 1917, except that in the case of a corporation or partnership which has fixed its own fiscal year, the first taxable year is the fiscal year ending during the calendar year 1917. (For special provisions as to prorating the amount of tax due for the portion of any fiscal year ending during the calendar year 1917, see articles 19 and 20.)

6. **Pre-war period.**—The term ''pre-war period'' means the calendar years 1911, 1912, and 1913, or if a corporation or partnership was not in existence or an individual was not engaged in the trade or business during the whole of such three years, then as many of such years during the whole of which the corporation or partnership was in existence or the individual was engaged in the trade or business.

7. **''Trade,'' ''business,'' ''trade or business'' in case of corporations and partnerships.**—In the case of a **corporation** or **partnership** all income from whatever source derived is deemed to be received from its trade or business, and the terms ''trade,'' ''business,'' and ''trade or business'' include all sources of income.

8. **''Trade'' in the case of individuals.**—In the case of an **individual**, the terms ''trade,'' ''business,'' and ''trade or business'' comprehend all his activities for gain, profit, or livelihood, entered into with sufficient frequency, or occupying such portion of his time or attention as to constitute a vocation, including occupations and professions. When such activities constitute a vocation they shall be construed to be a trade or business whether continuously carried on during the taxable year or not, and all the income arising therefrom shall be included in his return for excess-profits tax.

In the following cases the gain or income is not subject to excess-profits tax, and the capital from which such gain or income is derived shall not be included in "invested capital": (a) Gains or profits from transactions entered into for profit, but which are isolated, incidental, or so infrequent as not to constitute an occupation, and (b) the income from property arising merely from its ownership, including interest, rent, and similar income from investments except in those cases in which the management of such investments really constitutes a trade or business.

9. **"Dividend."**—The term "dividend" has the same meaning as in section 31 of the act of September 8, 1916, as amended by the act of October 3, 1917. (See Income Tax Regulations, art. 106.)

CORPORATIONS, PARTNERSHIPS AND INDIVIDUALS SUBJECT TO THE TAX

10. **Corporations.**—Every domestic corporation which has for the taxable year a net income of $3,000 or more is, unless exempt under article 13, required to make a return and to pay the tax, if any.

Every foreign corporation which has for the taxable year a net income of $3,000 or more from sources within the United States is, unless exempt under article 13, required to make a return and to pay the tax, if any.

11. **Partnerships.**—Every domestic partnership which has for the taxable year a net income of $6,000 or more is, unless exempt under article 13, required to make a return and to pay the tax, if any.

Every foreign partnership which has for the taxable year a net income of $3,000 or more from sources within the United States is, unless exempt under article 13, required to make a return and to pay the tax, if any.

12. **Individuals.**—Every citizen or resident of the United States who has for the taxable year an aggregate net income in excess of $6,000 from trades, businesses, occupations or professions, is, unless exempt under article 13, required to make a return and to pay the tax, if any.

Every non-resident alien individual who has for the taxable year an aggregate net income of $3,000 or more from trades, businesses, occupations, or professions carried on within the United States, is, unless exempt under article 13, required to make a return and to pay the tax, if any.

13. **Exemptions.**—The following are exempt from the tax:

(a) Corporations exempt under the provisions of section 11 of Title I of the act of September 8, 1916, from the tax imposed by such title. (See Income Tax Regulations, arts. 67, ff.)

(b) Partnerships carrying on or doing the same kind of business or coming within the same description.

(c) Individuals to the extent that they carry on or do the same kind of business or come within the same description.

RATES AND COMPUTATION OF TAX

14. **Classification of net income.**—For the purposes of the excess profits tax net income which is subject to the tax shall be divided into two classes, as follows:

A. Net income which is derived from a trade or business having no invested capital, or not more than a nominal capital, including, in the case of an **individual**, salaries, wages, fees, or other compensations; and

B. Net income which is derived from a trade or business having invested capital.

In the case of a **corporation or partnership**, all the trades and businesses in which it is engaged will be treated as a single trade or business

(as provided in sec. 201), and its entire income will be held to be of the same class as the income from its principal trade or business.

In the case of an **individual**, the net income subject to the excess profits tax shall be classified as provided in this article. Net income of class A shall be taxed as provided in article 15, and net income of class B shall be taxed as provided in article 16.

15. Rate of tax on income of class A.—The tax upon net income of class A, as defined in article 14, shall be computed at the rate of 8 per cent upon the amount thereof in excess of $3,000 in the case of a **domestic corporation**; upon the amount thereof in excess of $6,000 in the case of a **domestic partnership** or of a **citizen** or **resident** of the United States; and upon the whole thereof in the case of a **foreign corporation or partnership** or of a **non-resident alien individual.**

16. Rate of tax on income of class B.—The tax upon net income of class B, as defined in article 14, shall, except as otherwise provided in article 17, be computed at the following rates:

Twenty per cent of the amount of the net income in excess of the deduction (determined as provided in articles 21, 23 and 24) and not in excess of 15 per cent of the invested capital for the taxable year;

Twenty-five per cent of the amount of the net income in excess of 15 per cent and not in excess of 20 per cent of such capital;

Thirty-five per cent of the amount of the net income in excess of 20 per cent and not in excess of 25 per cent of such capital;

Forty-five per cent of the amount of the net income in excess of 25 per cent and not in excess of 33 per cent of such capital;

Sixty per cent of the amount of the net income in excess of 33 per cent of such capital.

Illustrations.—(1) A corporation has a capital of $100,000, pre-war earnings of 7 per cent, and a net income for the taxable year of $75,000.

The deduction allowed will be 7 per cent of the capital, or $7,000, plus $3,000 specific deduction, a total of $10,000.

The amount of the net income taxable at each rate will be as follows:

In excess of the deduction and not in excess of 15 per cent of the capital (rate, 20 per cent)	$5,000
In excess of 15 per cent of the capital and not in excess of 20 per cent thereof (rate, 25 per cent)	5,000
In excess of 20 per cent of the capital and not in excess of 25 per cent thereof (rate, 35 per cent)	5,000
In excess of 25 per cent of the capital and not in excess of 33 per cent thereof (rate, 45 per cent)	8,000
In excess of 33 per cent of the capital (rate, 60 per cent)	42,000

The tax would then be computed as follows:

20 per cent of $5,000	$1,000
25 per cent of $5,000	1,250
35 per cent of $5,000	1,750
45 per cent of $8,000	3,600
60 per cent of $42,000	25,200
Total tax	$32,800

(2) An individual or partnership has a capital of $100,000, pre-war earnings of 8 per cent, and a net income for the taxable year of $22,500.

The deduction allowed will be 8 per cent of the capital, or $8,000, plus $6,000 specific deduction, a total of $14,000.

The amount of the net income taxable at each rate will be as follows:

In excess of the deduction and not in excess of 15 per cent of the capital (rate, 20 per cent)	$1,000
In excess of 15 per cent of the capital and not in excess of 20 per cent thereof (rate, 25 per cent)	5,000
In excess of 20 per cent of the capital and not in excess of 25 per cent thereof (rate, 35 per cent)	2,500

The tax would then be computed as follows:

20 per cent of $1,000	$200
25 per cent of $5,000	1,250
35 per cent of $2,500	875
Total tax	$2,325

17. **When deduction exceeds 15 per cent of invested capital.**—In any case in which the deduction determined as provided in articles 21, 23 and 24 is greater than 15 per cent of the invested capital and therefore cannot be fully allowed under the first rate or bracket of article 16, then any remaining portion of the deduction will be allowed under the second bracket, and continued if necessary into the succeeding bracket or brackets until the entire amount of the deduction is allowed.

Illustrations.—(1) A corporation has a capital of $9,000; pre-war earnings of 9 per cent; and a net income for the taxable year of $10,000.

The deduction allowed will be 9 per cent of the capital, or $810, plus $3,000 specific deduction, a total of $3,810.

The amount of the net income in each bracket will be as follows:

15 per cent of the capital	$1,350
In excess of 15 per cent of the capital and not in excess of 20 per cent thereof	450
In excess of 20 per cent of the capital and not in excess of 25 per cent thereof	450
In excess of 25 per cent of the capital and not in excess of 33 per cent thereof	720
In excess of 33 per cent of the capital	7,030

It is evident that the total deduction of $3,810 is greater than 15 per cent of the capital and so is not fully absorbed by the amount of net income not in excess of 15 per cent of the capital. In such case, applying article 17, the total deduction of $3,810 will be distributed as follows:

$1,350 in the first bracket, leaving nothing to be taxed at the 20 per cent rate.

$450 in the second bracket, leaving nothing to be taxed at the 25 per cent rate.

$450 in the third bracket, leaving nothing to be taxed at the 35 per cent rate.

$720 in the fourth bracket, leaving nothing to be taxed at the 45 per cent rate.

There still remains $840 of the deduction to be allowed in the fifth bracket against the $7,030 of income which would otherwise be taxable under that bracket. There would then be $6,190 of net income left to be taxed at the 60 per cent rate under the fifth bracket. Hence, the total excess profits tax in this case would be $3,714.

(2) An individual or partnership has a capital of $40,000, pre-war earnings of 9 per cent, and a net income for the taxable year of $12,000.

The deduction allowed will be 9 per cent of the capital, or $3,600, plus $6,000 specific deduction, a total of $9,600.

The amount of the net income in each bracket will be as follows:

15 per cent of the capital	$6,000
In excess of 15 per cent of the capital and not in excess of 20 per cent thereof	2,000
In excess of 20 per cent of the capital and not in excess of 25 per cent thereof	2,000
In excess of 25 per cent of the capital and not in excess of 33 per cent thereof	2,000

It is evident that the total deduction of $9,600 is greater than 15 per cent of the capital and so is not fully absorbed by the amount of net income not in excess of 15 per cent of the capital. In such case, applying article 17, the total deduction of $9,600 will be distributed as follows:

$6,000 in the first bracket, leaving nothing to be taxed at the 20 per cent rate.

$2,000 in the second bracket, leaving nothing to be taxed at the 25 per cent rate.

$1,600, the balance of the deduction, to be allowed against the $2,000 of income in the third bracket.

There would then be $400 of income left in the third bracket to be taxed at the 35 per cent rate, and $2,000 in the fourth bracket to be taxed at the 45 per cent rate. Hence, the total excess profits tax in this case would be $1,040.

18. **Constructive capital for application of rates.**—Where the deduction allowed to a taxpayer is determined under article 24, the invested capital for the purpose of applying the rates of taxation under article 16 shall be deemed to be an amount which bears the same ratio to the net income of the trade or business for the taxable year which the average invested capital for the corresponding calendar year of representative corporations, partnerships and individuals engaged in a like or similar trade or business bears to their average net income.

The Commissioner of Internal Revenue in determining for any calendar year the ratio which the average invested capital of representative corporations, partnerships and individuals engaged in any particular trade or business bears to their average net income, will include the invested capital and net income of representative corporations and partnerships for fiscal years ending during such calendar year.

For the purpose of applying this article in the case of a corporation or partnership which has fixed its own fiscal year, the ratio determined for the calendar year ending during such fiscal year shall be used.

19. **Computation of tax for fiscal year, part of which falls within calendar year 1916.**—If a **corporation** or **partnership** prior to March 1, 1918, makes a return for a fiscal year, part of which falls within the calendar year 1916, the tax for the first taxable year shall be that proportion of the tax computed upon the net income for such fiscal year which the number of months from January 1, 1917, to the end of such fiscal year bears to the entire number of months in such fiscal year.

20. **Computation of tax for period of less than 12 months.**—If a **corporation or partnership** at any time, either because it has just designated a fiscal year as provided in sections 8 or 13 of the act of September 8, 1916 (see Income Tax Regulations, arts. 31 and 211), or for any other reason, makes a return for a period of less than 12 months, the deduction will be an amount which bears the same ratio to the deduction allowable for a full year as the number of months in such period bears to 12 months.

COMPUTATION OF THE DEDUCTION

21. **Trade or business having invested capital.**—The deduction used in computing the rates of tax under article 16 shall, except in cases coming within the conditions specified in articles 23 and 24, be as follows:

(a) In the case of a **domestic corporation** the sum of (1) an amount

equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the pre-war period was of the invested capital for the pre-war period (except that 7 per cent shall be used if such percentage was less than 7 per cent, and 9 per cent shall be used if such percentage was more than 9 per cent, and 8 per cent shall be used if the corporation was not in existence during the whole of at least one calendar year during the pre-war period), and (2) $3,000.

(b) In the case of a **domestic partnership** or of a **citizen or resident** of the United States, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the pre-war period was of the invested capital for the pre-war period (except that 7 per cent shall be used if such percentage was less than 7 per cent, and 9 per cent shall be used if such percentage was more than 9 per cent, and 8 per cent shall be used if the partnership was not in existence or the individual was not engaged in the trade or business during the whole of at least one calendar year during the pre-war period), and (2) $6,000.

(c) In the case of a **foreign corporation** or **partnership** or of a **non-resident alien individual**, an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the pre-war period was of the invested capital for the pre-war period (except that 7 per cent shall be used if such percentage was less than 7 per cent, and 9 per cent shall be used if such percentage was more than 9 per cent, and 8 per cent shall be used if the corporation or partnership was not in existence or the individual was not engaged in the trade or business during the whole of at least one calendar year during the pre-war period).

22. **Trade or business reorganized on or after January 2, 1913.**—If a trade or business carried on by a **corporation, partnership** or **individual** was formerly organized or reorganized on or after January 2, 1913, but is substantially a continuation of a trade or business carried on prior to that date, then the corporation or partnership shall be deemed to have been in existence, or the individual shall be deemed to have been engaged in the trade or business, prior to that date, and for the purpose of computing the deduction the net income and invested capital of the predecessor shall be deemed to have been the net income and invested capital of the present owner for the pre-war period.

23. **When income for pre-war period cannot be satisfactorily determined, or when net income was low during pre-war period, or when there was no net income during pre-war period.**—In the following cases the deduction shall be determined as provided in this article:

(a) If the Secretary of the Treasury is unable satisfactorily to determine the average amount of annual net income of the trade or business for the pre-war period;

(b) If the Secretary of the Treasury upon complaint finds that during the pre-war period the percentage of the net income to the invested capital of the taxpayer was lower by one per cent or more than the percentage of the net income to the invested capital of representative corporations, partnerships or individuals engaged in a like or similar trade or business during the same period.

(c) If, in the case only of a **domestic corporation or partnership** which was in existence during the pre-war period, or of a **citizen or resident** of the United States who was engaged in the trade or business during the pre-war period, the Secretary of the Treasury upon complaint finds that during the pre-war period there was no net income from the trade or business.

In such cases the deduction shall be—

(1) An amount equal to the same percentage of the invested capital

for the taxable year which the average deduction (determined in the same manner as provided in article 21, without including the $3,000 or $6,000 therein referred to) for such year of representative corporations, partnerships or individuals engaged in a like or similar trade or business, is of their average invested capital for such year, plus

(2) In the case of a **domestic corporation,** $3,000, and in the case of a **domestic partnership** or a **citizen** or **resident** of the United States, $6,000.

In cases arising under subdivision (a) or (c) of this article the tax shall be assessed in the first instance upon the basis of a deduction computed by the use of 7 per cent. In cases arising under subdivision (b) the tax shall be assessed in the first instance upon the basis of a deduction determined as provided in article 21.

In any case under this article a taxpayer claiming the benefit of this provision shall at the time of making the return file a claim for abatement (Form 47) of the amount by which the tax so assessed exceeds a tax computed upon the basis of the deduction determined as provided in this article. In cases coming within the provisions of this article payment of that portion of the tax covered by the claim for abatement will not be required until the claim is decided. If, however, in the judgment of the Commissioner of Internal Revenue, the interests of the United States would be jeopardized thereby, the right is reserved to require the claimant to give a bond of such amount and with such sureties as the commissioner thinks wise to safeguard such interests. The bond shall be conditioned for the payment of any tax found to be due with interest thereon, and if a bond satisfactory to the commissioner is not given within such time as he prescribes, the full amount of the tax assessed will become immediately due and the amount overpaid, if any, will, upon final decision of the application, be refunded as a tax erroneously or illegally collected.

24. **When invested capital cannot be satisfactorily determined.**—If the Secretary of the Treasury is unable satisfactorily to determine the invested capital, the deduction shall be the sum of—

(1) An amount equal to the same proportion of the net income of the trade or business for the taxable year as the average deduction (determined in the same manner as provided in article 21 without including the $3,000 or $6,000 therein referred to) for the corresponding calendar year, of representative corporations, partnerships and individuals engaged in a like or similar trade or business, is of their average net income, plus

(2) In the case of a **domestic corporation,** $3,000, and in the case of a **domestic partnership** or a **citizen** or **resident** of the United States, $6,000.

The Commissioner of Internal Revenue in determining for any calendar year the proportion which the average deduction of representative corporations, partnerships and individuals engaged in any particular trade or business is of their average net income, will include the deductions and net income of representative corporations and partnerships for fiscal years ending during such calendar year.

For the purpose of applying this article in the case of a corporation or partnership which has fixed its own fiscal year, the proportion determined for the calendar year ending during such fiscal year shall be used.

In every case of a trade or business having invested capital a return shall be made in the first instance in accordance with article 21 or 23, but the taxpayer may submit therewith a statement of reasons why in his opinion the tax should be assessed in accordance with this article.

NET INCOME—GENERAL PROVISIONS

25. **Exemptions.**—The following classes of income are exempt from the tax:

(a) Income exempt from taxation under section 4 of the act of September 8, 1916, as amended. (See Income Tax Regulations, art. 5.)

(b) Income derived from the business of life, health, and accident insurance combined in one policy issued on a weekly premium payment plan.

(c) Compensation or fees received by officers and employees under the United States or any State, Territory or the District of Columbia for their services as such.

26. **Net income of foreign corporations, partnerships and non-resident alien individuals.**—In the case of a foreign corporation or partnership or a non-resident alien individual the net income shall be the net income from sources within the United States.

27. **Dividends received from a foreign corporation which is subject to Federal income tax.**—In the case of income derived by a corporation or partnership from dividends upon the stock of a foreign corporation, part of whose net income is subject to the income tax, there shall be deducted only that proportion of the dividends received upon such stock which the net income of such foreign corporation from sources within the United States is of its entire net income.

Where dividends upon the stock of a foreign corporation are received by an individual, as a part of his income from trade or business, there shall be included in the net income that proportion of the dividends received upon such stock which the net income of such corporation from sources outside the United States is of its entire net income.

NET INCOME—CORPORATIONS

28. **Taxable year.**—The net income of a corporation for the taxable year shall be determined by adding (1) the amount of net income ascertained and returned for income tax purposes for such taxable year as provided in Title I of the act of September 8, 1916, as amended, and (2) the amount, if any, received as interest on bonds or other obligations of the United States, issued after September 24, 1917 (other than the interest received on an amount of such bonds or obligations the aggregate principal of which does not exceed $5,000), and deducting from the total so obtained the amounts received during the taxable year as dividends upon the stock or from the net earnings of other corporations, joint-stock companies or associations, or insurance companies, subject to the income tax imposed by Title I of such act of September 8, 1916, as amended, except as otherwise provided in article 27.

29. **Pre-war period.**—The net income of a corporation for the pre-war period shall be computed as follows:

(a) For the calendar year 1911 by adding (1) the amount of net income shown in item 9 of the return made under section 38 of the act of August 5, 1909, for the calendar year 1911, and (2) the amount of taxes paid to the United States within the calendar year 1911 under section 38 of such act;

(b) For the calendar year 1912 by adding (1) the amount of net income shown in item 9 of the return made under section 38 of the act of August 5, 1909, for the calendar year 1912, and (2) the amount of taxes paid to the United States within the calendar year 1912 under section 38 of such act; and

(c) For the calendar year 1913 by adding (1) the amount of the entire net income shown in item 8 of the return made under Section II of the act of October 3, 1913, for the calendar year 1913, and (2) the amount of taxes paid within the calendar year 1913 under section 38 of the act of August 5, 1909, and Section II or IV of the act of October 3, 1913, and deducting from the total so obtained the amounts received during the calendar year 1913 as dividends upon the stock or from the net earnings of other corporations, joint-stock companies or associations, or insurance companies, subject to the income tax imposed by Section II of the act of October 3, 1913.

NET INCOME—PARTNERSHIPS

30. **Taxable year.**—The net income of a **partnership** for the taxable year shall be determined by adding the amount of its entire net income (or in the case of a foreign partnership, its entire net income from sources within the United States) ascertained upon the same basis and in the same manner as provided with respect to individuals for income-tax purposes by Title I of the act of September 8, 1916, as amended (see Income Tax Regulations, art. 30), including the amounts, if any, received during the year as interest on bonds or other obligations of the United States issued after September 24, 1917 (other than the interest on an amount of such bonds or obligations, the aggregate principal of which does not exceed $5,000), and deducting therefrom—

(1) The amounts received during the taxable year as dividends upon the stock or from the net earnings of corporations, joint-stock companies or associations, or insurance companies, subject to the income tax imposed by Title I of the act of September 8, 1916, as amended, except as otherwise provided in article 27; and

(2) The deductions, if any, for salaries or interest allowed by articles 32 and 33, if such deductions have not already been made.

31. **Pre-war period.**—The net income of a **partnership** for each of the calendar years 1911, 1912 and 1913 shall be determined in the same manner as the net income for the taxable year, except that dividends upon the stock or from the net earnings of corporations, joint-stock companies or associations, or insurance companies, subject to the tax imposed by section 38 of the act of August 5, 1909, or by Section II of the act of October 3, 1913, shall be deducted. (See art. 30.)

32. **Deductions allowed for salaries paid to partners.**—In computing net income for purposes of the excess profits tax a **partnership** will be allowed to deduct as an expense reasonable salaries or compensation paid to individual partners for personal services actually rendered during the taxable year, if the payments are made in accordance with prior agreements and are properly recorded on the books of the partnership. In no case shall the salaries or compensation so deducted be in excess of the salaries or compensation customarily paid for similar services under like responsibilities by corporations engaged in like or similar trades or businesses.

With respect to any period prior to March 1, 1918, regardless of whether a previous agreement has been made as to salaries or compensation, a similar deduction will be allowed for services actually rendered.

In the case of a foreign partnership the deduction shall be limited to those portions of salaries or compensation which are paid for services rendered with respect to trade or business carried on in the United States.

A partner in his individual capacity is, however, subject to the excess profits tax, if any, at the 8 per cent rate under article 15 with respect to any salary or compensation from the partnership for personal services (including any amounts allowed to the partnership as a deduction on his account for the period prior to March 1, 1918).

33. **Deductions allowed for interest on bona fide loans by partners**—In computing net income for purposes of the excess profits tax a **partnership** will be allowed to deduct amounts paid during the year to an individual partner as interest upon any bona fide loan, but no deduction for so-called interest upon capital will be allowed.

34. **If deduction is made under article 32 or 33, corresponding deduction must also be made for pre-war period.**—If, in computing net income for purposes of the excess profits tax, a **partnership** makes a deduction as allowed by article 32 for salaries paid to partners during the taxable year, it must also, in computing net income for the pre-war period, make

a corresponding deduction; and if it makes such a deduction as allowed by article 33 for interest paid to partners, it must also, in computing net income for the pre-war period, make a corresponding deduction for any such interest actually paid during that period.

NET INCOME—INDIVIDUALS

35. **Determination of net income where there is no invested capital or only nominal capital.**—The net income which is derived from a trade or business having no invested capital or not more than a nominal capital, including salaries, wages, fees or other compensations (constituting net income of class A as defined in art. 14) shall be determined for the taxable year by adding the total net income from all such sources (or in the case of a **non-resident alien individual** the total net income from all such sources within the United States) as reported for income tax purposes for the same year.

36. **Determination of net income for taxable year when there is invested capital.**—The net income which is derived from a trade or business having invested capital (constituting net income of class B, as defined in art. 14) shall be determined for the taxable year by adding the total net income from such sources (or in the case of a **non-resident alien individual** the total net income from such sources within the United States) as reported for income tax purposes for the same year and deducting therefrom the deduction, if any, for salary allowed by article 39, if such deduction has not already been made.

There shall be excluded the amounts received during the year upon the stock or from the net earnings of corporations, joint-stock companies or associations, or insurance companies, subject to the income tax imposed by Title I of the act of September 8, 1916, as amended.

In the case, however, of an individual dealing in securities or otherwise using securities in trade or business there shall be included (1) the amount, if any, received as interest on bonds or obligations of the United States, issued after September 24, 1917 (other than the interest received on an amount of such bonds or obligations the aggregate principal of which does not exceed $5,000), and (2) such proportion of dividends received upon the stock of foreign corporations as is required to be included by article 27.

Illustration.—An individual owns a farm representing an invested capital of $25,000, a country store with an invested capital of $6,000, and a flour mill with an invested capital of $10,000. His net income from the farm is $4,000, from the store $3,000, and from the mill $3,000. Thus his total net income of class B is $10,000. His total invested capital is $41,000. Assuming that his deduction is at the rate of 8 per cent, his total deduction will be $3,280 plus $6,000, or $9,280, to be applied against his net income of $10,000 in computing the tax at the graduated rates under articles 16 and 17.

The same individual allows himself a salary of $1,000 for working the farm and $900 for running the store, draws a salary of $1,200 as president of the local bank, and receives $250 in compensation for personal services of various kinds, such as road work, helping neighbors in harvest, etc. He also receives $300 in dividends on an investment in certain stocks and $100 as supervisor's fees. The last item—that is, supervisor's fees—is exempt under the law (sec. 201, subdivision a). The $300 in dividends is not taxable, inasmuch as it is derived from a mere investment not connected with his trade or business. His net income of class A will therefore consist of his salaries and his compensation for personal services, a total of $3,350. Since he is entitled to a deduction of $6,000 as to this class of income, he will have no tax to pay at the 8 per cent rate under article 15.

37. **Deduction of contributions for religious, charitable, etc., purposes.**

—Contributions or gifts for religious, charitable, etc., purposes allowed as a deduction for purposes of the income tax under paragraph "Ninth" of subdivision (a) of section 5 of the act of September 8, 1916, as amended, may, subject to the limitations therein contained, be deducted in computing the net income of the trade or business for purposes of the excess profits tax only when it is shown to the satisfaction of the Commissioner of Internal Revenue that such contributions or gifts are made by the trade or business and not by the individual in his personal capacity.

38. **Determination of net income for the pre-war period where there is invested capital.**—The net income which is derived from a trade or business having invested capital (constituting net income of class B as defined in article 14) shall be determined for each of the calendar years 1911, 1912 and 1913 upon the same basis and in the same manner as provided in article 36.

39. **Deduction allowed for salary to himself.**—An individual carrying on a trade or business having an invested capital may, in computing the net income of the trade or business for purposes of the excess profits tax, deduct a reasonable amount designated by him as salary or compensation for personal service actually rendered by him in the conduct of such trade or business. In no case shall the amount so designated be in excess of the salaries or compensation customarily paid for similar service under like responsibilities by corporations or partnerships engaged in like or similar trades or businesses.

In the case of a **non-resident alien individual**, the amount deducted shall be limited to that portion of the salary or compensation which is for service rendered with respect to trade or business carried on in the United States.

The amount so designated shall, however, be included in computing his net income of class A under article 35; and the balance of the income from his trade or business shall be included in computing his net income of class B under article 36.

Illustration.—An individual owns and runs a newspaper having an invested capital of $50,000. The net income from the newspaper, without making any allowance for the salary of the owner, is $20,000, and, as income of class B, is subject to the graduated rates prescribed in article 16. His deduction, as provided for in subdivision (b) of article 21, would be $4,500 (9 per cent of his capital), plus $6,000, a total of $10,500. If, however, he allows himself a salary of $3,000, the net income from the newspaper will be $17,000, and the deduction of $10,500 will be applied against that amount.

His salary of $3,000 must be included in his return as income of class A, which is subject to the 8 per cent rate under article 15. If it constitutes his only income of that class he will pay no tax thereon, inasmuch as it is less than the deduction of $6,000 to which he is entitled as to that class of income. But if, for example, he receives in addition a salary of $4,000 as president of the local bank, his total net income of class A will be $7,000, and he will be required to pay a tax of 8 per cent on $1,000 thereof, or $80.

40. **If deduction is made under article 39 corresponding deduction must also be made for pre-war period.**—If, in computing net income for purposes of the excess profits tax, an individual deducts a reasonable amount designated as salary or compensation for personal services rendered by himself, as allowed by article 39, he must also, in computing net income for the pre-war period, make a corresponding deduction.

41. **Individual member of partnership.**—Inasmuch as a partner in his individual capacity is not considered to be engaged in trade or business with respect to his share in the profits of the partnership, he is not subject to excess profits tax thereon. Consequently, in computing his net

income for purposes of the excess profits tax, he need not include his share of the partnership profits.

He shall, however, in computing his net income of class A under article 35, include any salary or compensation from the partnership for personal services (including any amount allowed to the partnership as a deduction on his account for the period prior to March 1, 1918, in accordance with article 32).

INVESTED CAPITAL—GENERAL PROVISIONS

42. **Allowance for depletion, depreciation, and obsolescence in computation of invested capital.**—The term ''invested capital'' as used in the excess profits tax law means the invested capital of the present owner. The basis, or starting point, in the computation of invested capital is found in the amount of cash and other property paid in, the original values of such other property being determined in accordance with the rules laid down in these regulations. But the computation does not stop with such original entries or amounts; it must take properly into account the surplus and undivided profits. In the computation of surplus and undivided profits, however, full recognition must first be given to expenses incurred and losses sustained from the original organization of the business concern down to the taxable year, including among such expenses and losses a reasonable allowance for depletion, depreciation, or obsolescence of property originally acquired for cash or for stock or shares or in any other manner. If value appreciation of a kind not subject to income tax (other than that allowed under article 55) has been taken up in the accounts, a deduction must be made in respect of such appreciation so taken up. In the computation of the invested capital for any year full effect must also be given to any liquidation of the original capital.

43. **How to ascertain average invested capital for the year, averaged monthly.**—The invested capital for any pre-war or taxable year (or where the tax is computed upon the basis of a period less than a year, for such period) is the average invested capital for the year or period averaged monthly, according to the following rules:

(a) Add the capital for each of the several months during which no change occurs, and the average capital (ascertained as provided in subdivision (b) of this article) for each month in which a change occurs and divide the total by the number of months in the year or period.

(b) To ascertain the capital for any month in which a change occurs multiply the capital as of the first day of the month by the number of days it remains constant and the capital after each change by the number of days (including the day on which the change occurs) during which it remains constant, add the products, and divide the sum by the number of days in the month.

44. **Items not allowed to be included in invested capital.**—The second paragraph of section 207 of the excess profits law specifies certain items which may not be included in invested capital, namely:

(a) Stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the excess profits tax; and

(b) Money or other property borrowed.

The term ''money or other property borrowed'' as used in section 207 and these regulations includes not only cash or other borrowed property which can be identified as such, but current liabilities and temporary indebtedness of all kinds, and any permanent indebtedness upon which the taxpayer is entitled to an interest deduction in computing net income. A corporation which under the income-tax law is allowed to deduct only a part of the entire interest paid upon its indebtedness, may include in its invested capital such a proportion of its permanent indebt-

edness as the amount of interest upon such indebtedness which the corporation is not allowed to deduct is of the total amount of interest paid upon such indebtedness during the taxable year.

45. **When income from tax-free securities consists partly of trading profits and partly of interest, dividends, etc.**—Whenever income consists partly of gains or profits subject to the excess profits tax arising from trading in stocks, bonds, etc., the dividends or interest on which are not subject to such tax, and partly of such dividends or interest, then, subject to the limitations as to borrowed money, there shall be included in the invested capital an amount which bears the same ratio to the total amount invested in such stocks or bonds as the amount of such gains or profits bears to the total amount of such income.

46. **Treatment of stock of foreign corporations when held by domestic corporations or partnerships or by citizens or residents of the United States.**—In the case of **domestic corporations or partnerships** and of **citizens** or **residents** of the United States holding stock in a foreign corporation part of whose net income is subject to the income tax, there shall be included in invested capital such proportion of the value of the stock in such foreign corporation as the net income of such foreign corporation from sources outside the United States is of its entire net income.

47. **Construction of terms ''tangible property'' and ''intangible property.''**—The term ''other intangible property'' as used in section 207 will be construed to mean property of a character similar to good will, trade-marks, and the other specific kinds of property enumerated in the same clause. With respect to property not clearly of such a character, rulings will be issued as occasion may demand to indicate whether it shall be regarded as tangible or intangible.

The following classes of property, when paid in for stock or shares in a corporation or partnership, will be regarded as tangible property so paid in:

(a) Stocks.
(b) Bonds.
(c) Bills and accounts receivable.
(d) Notes and other evidences of indebtedness.
(e) Leaseholds.

But when a corporation pays for intangible property by the issuance of its own stock or bonds, this will not be regarded as being a payment bona fide made in cash or tangible property within the meaning of section 207.

48. **Invested capital of foreign corporations or partnerships or non-resident alien individuals.**—When used with reference to a **foreign corporation or partnership** or a **non-resident alien individual**, the term ''invested capital'' means that proportion of the entire invested capital as defined and limited by these regulations which the net income from sources within the United States is of the entire net income.

49. **Reorganization on or after January 2, 1913.**—A trade or business carried on by a **corporation, partnership, or individual**, which has been formerly organized or reorganized on or after January 2, 1913, but which is substantially a continuation of a trade or business carried on prior to that date, shall, for the purposes of the excess profits tax, be deemed to have been in existence prior to that date and the invested capital of its predecessor prior to that date shall be deemed to have been its invested capital. This article relates to the pre-war period and does not apply to the invested capital for the taxable year.

50. **Reorganization after March 3, 1917.**—In case of the reorganization, consolidation, or change of ownership of a trade or business after March 3, 1917, if an interest or control in such trade or business of 50 per cent or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received

from the prior trade or business shall be allowed a greater value than would have been allowed under these regulations in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in cash or tangible property, and then not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment.

51. **Invested capital for pre-war period.**—The invested capital for the pre-war period shall, in general, be determined in the same manner as for the taxable year, except that the valuation as of January 1, 1914, shall not apply to tangible property paid in for stock or shares.

52. **Scope of section 210.**—Section 210 provides for exceptional cases in which the invested capital can not be satisfactorily determined. In such cases the taxpayer may submit to the Commissioner of Internal Revenue evidence in support of a claim for assessment under the provisions of section 210. (See articles 18 and 24.) Such exceptional cases may consist, among others, of the following:

(1) Where, through defective accounting or the lack of adequate data, it is impossible accurately to compute invested capital.

(2) Where upon application by a foreign taxpayer the Secretary of the Treasury finds that the expense of securing the data necessary for the computation of the invested capital would be unreasonable in view of the amount of tax involved, or that it is impracticable to determine either the "entire invested capital" or the "entire net income."

(3) Long-established business concerns which by reason of ultra-conservative accounting or the form and manner of their organization would, through the operation of section 207, be placed at a serious disadvantage in competing with representative concerns in a like or similar trade or business.

(4) Where the invested capital is seriously disproportionate to the taxable income. Such cases may arise through:

(a) The realization in one year of the earnings of capital unproductively invested through a period of years or of the fruits of activities antedating the taxable year; or,

(b) Inability to recognize or properly allow for amortization, obsolescence, or exceptional depreciation due to the present war, or to the necessity in connection with the present war of providing plant which will not be wanted for the purposes of the trade or business after the termination of the war.

INVESTED CAPITAL—CORPORATIONS AND PARTNERSHIPS

53. **Rule for computing invested capital.**—In computing invested capital, every corporation or partnership paying taxes at the graduated rates prescribed in section 201 (see art. 16), shall add together its **paid in capital** and its **paid in or earned surplus and undivided profits** (under whatever name the same may be called) as shown by its books at the beginning of the taxable year. The total thus obtained shall be adjusted for any asset or item which it covers that is not carried on the books at the valuation prescribed by law or by these regulations. When necessary, adjustment (addition or subtraction) shall be made in respect of the following:

ADJUSTMENTS

1. Stock or shares issued in the purchase of intangible property prior to March 3, 1917, which cannot be included in an amount exceeding (a) 20 per cent of the par value of the total stock or shares outstanding on that date, (b) the actual value of such intangible property at the date acquired, or (c) the par value of the stock or shares issued in payment therefor, whichever is the lowest. (See arts. 57 and 58.)

2. Stock or shares issued for a mixed aggregate of tangible property, patents and copyrights, and good will or other intangible property. (See art. 59.)

3. Stock or shares issued for patents and copyrights, valued at (a) their actual cash value at the time of payment, or (b) the par value of the stock or shares issued therefor, whichever is lower. (See art. 56.)

4. Stock or shares issued for tangible property prior to January 1, 1914, valued at (a) the actual cash value of such property on January 1, 1914, or (b) the par value of the stock, whichever is the lower. (See art. 55.)

5. Stock originally issued for property and subsequently returned to the corporation as a gift, etc. (See art. 54.)

6. Add any proportion of its permanent indebtedness which may be included under article 44.

7. Add value of tangible property paid in for stock or shares in excess of the par value of such shares, when authorized by article 63.

8. Add amounts expended in the past for (a) the acquisition of tangible property or (b) specifically for good will and other similar intangible property, when authorized by article 64.

9. For the valuation of assets acquired in reorganizations, etc., (a) effected after March 3, 1917, see article 50; (b) as to the pre-war period, see articles 49 and 51.

10. Deduct amounts representing appreciation excluded by article 42.

11. Make any additional deductions required by reason of insufficient allowances in the accounts of the taxpayer for depletion, depreciation and obsolescence. (See art. 42.)

Whenever any corrections are made in respect of the capital stock and surplus, corresponding corrections must be made in the respective asset items in the balance sheet of the taxpayer.

After making any adjustments required under paragraphs 1 to 11 above, the adjusted total of the capital and surplus account will represent the invested capital at the beginning of the taxable year, except that in any case where the admissible assets (and these include all assets when valued in accordance with these regulations, except stocks, bonds—other than obligations of the United States—the income of which is not subject to excess profits tax) are less than the amount of such adjusted total, then the invested capital must be further reduced to an amount equal to the sum of the admissible assets. Tax-free securities and stock in foreign corporations may be included as admissible assets to the extent authorized in articles 45 and 46.

If there has been any change made during the taxable year in the amount of the invested capital, the monthly average shall be taken (see art. 43), but in no case may the invested capital include any surplus or undivided profits earned during the taxable year.

With respect to the taxable year 1917, every such corporation and partnership will be required to submit a balance sheet as at the first day of the taxable year and also a balance sheet as at the close of the taxable year. Thereafter every such corporation and partnership will be required to submit a balance sheet as at the close of each taxable year. Balance sheets should be made in accordance with the books of the taxpayer and changes in respect of any items therein made pursuant to these regulations should be explained in a separate statement attached to the balance sheet to which it relates.

54. **Stock returned to corporation.**—For the purpose of computing invested capital, in cases where the stock of a corporation is issued or exchanged for property (tangible or intangible), the following rule will apply:

When any of such stock is returned to the corporation as a gift or for a consideration substantially less than its par value, the stock so returned shall not be treated as a part of the stock issued or exchanged

for such property. The proceeds derived in cash or its equivalent from the resale of the stock so returned shall, however, be included in the invested capital if retained and employed in the business.

55. Valuation of tangible property paid in for stock or shares.—Tangible property paid in for stock or shares prior to January 1, 1914, must be valued at either (a) the actual cash value of such property on January 1, 1914, or (b) the par value of the stock or shares specifically issued therefor, whichever is lower. This is one of the few cases in which the law permits allowance to be made for appreciation, and here no appreciation can be recognized unless the original stock or shares were specifically issued in exchange for such tangible property.

Tangible property paid in for stock or shares on or after January 1, 1914, will be taken at the actual cash value of such property at the time of payment, irrespective of the par value of the stock or shares.

56. Patents and copyrights.—Patents and copyrights paid in for stock or shares must be valued at either (a) the actual cash value at the time of payment or (b) the par value of the stock or shares issued therefor, whichever is lower.

57. Valuation of intangible property.—If good will, trade marks, trade brands, franchises of a corporation or partnership, or other intangible property has been purchased with stock or shares issued prior to March 3, 1917, the amount that may be included in invested capital must not exceed (a) 20 per cent of the par value of the total stock or shares outstanding on that date, nor (b) the actual value of the asset at the date acquired, nor (c) the par value of the stock issued in payment for the asset.

58. Application of 20 per cent limitation upon intangible property.—The 20 per cent limitation upon intangible property purchased prior to March 3, 1917, for or with stock or shares of the corporation or partnership, applies not to each item or class of intangible property separately, but to the aggregate amount of all such property so purchased. Such intangible property may be included in the invested capital only up to an amount not exceeding 20 per cent of the total stock or shares of the corporation or partnership on March 3, 1917, even though the aggregate amount of such intangible property be greater in value than such 20 per cent of the par value of the total stock or shares.

Intangible property bona fide purchased prior to March 3, 1917, with stock having no par value may be included in invested capital at a value not exceeding the actual cash value of such intangible property at the time of the purchase and in an amount not exceeding 20 per cent of the total shares of stock outstanding on March 3, 1917, measured by their value as at the date or dates of issue.

59. Rules to govern cases where shares or securities are issued for mixed aggregate of tangible and intangible property.—Where stock or shares (or stocks or shares and bonds or other obligations) have, prior to March 3, 1917, been issued for a mixed aggregate of—

(a) Tangible property,
(b) Patents and copyrights, and
(c) Good will or other intangible property,

the following rules will govern:

(1) In the absence of satisfactory evidence to the contrary, it will be presumed, in the case of a corporation, that its stock was issued for the following purposes in the order named:

(a) Good will or other intangible property,
(b) Patents and copyrights, and
(c) Tangible property.

(2) Upon the production by the taxpayer of evidence satisfactory to the Commissioner of Internal Revenue as to the actual values at the date of acquisition of (a) the tangible property and (b) the patents and copyrights, the sum of these two items may be applied against the total par

value of the securities issued and the remainder will then be deemed to represent the par value of the securities issued for the good will or other intangible property.

(3) Cases where mixed aggregates of tangible and intangible property have been paid in for stock and bonds shall, if the Secretary of the Treasury is unable to determine satisfactorily the respective values of the several classes of property at the time of payment, be treated as coming under articles 18 and 24 and the tax shall be assessed accordingly.

60. **Valuation of intangible assets purchased.**—Good will and other similar intangible assets purchased with cash or tangible property must be taken at a value not in excess of the cash or actual cash value of the tangible property specifically paid therefor.

61. **Surplus or undivided profits earned during any year excluded in computing invested capital for such year.**—Profits earned during any taxable year or pre-war year shall not be included in the computation of the invested capital for such year, even though set up as ''surplus'' upon the books or distributed in the form of stock dividends.

62. **Scope of phrase ''surplus and undivided profits.''**—Clause (3) of subdivision (a) of section 207 authorizes the inclusion in invested capital of earned surplus and undivided profits used or employed in the business. Inasmuch as section 201 provides that all the income of a corporation or partnership shall be deemed to be received from its trade or business, all the surplus and undivided profits of a corporation or partnership (exclusive of undivided profits earned during the year), from whatever source derived, will, unless invested in stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the excess profits tax, be deemed to be used or employed in the business and may be included in the invested capital.

63. **When tangible property may be included in surplus.**—Where it can be shown by evidence satisfactory to the Commissioner of Internal Revenue that tangible property has been conveyed to a corporation or partnership by gift or at a value, accurately ascertainable or definitely known as at the date of conveyance, clearly and substantially in excess of the cash or the par value of the stock or shares paid therefor, then the amount of the excess shall be deemed to be paid in surplus. The adopted value shall not cover mineral deposits or other properties discovered or developed after the date of conveyance, but shall be confined to the value accurately ascertainable or definitely known at that time.

Evidence tending to support a claim for a paid-in surplus under these circumstances must be as of the date of conveyance, and may consist, among other things, of (1) an appraisal of the property by disinterested authorities, (2) the assessed value in the case of real estate, and (3) the market price in excess of the par value of the stock or shares.

64. **Reconstruction of surplus and undivided profits accounts.**—Where through failure to provide for depletion, depreciation, obsolescence, or other expenses or losses, or where for any other cause or reason the books of account of the taxpayer do not show the true paid-in or earned surplus and undivided profits, in the computation of invested capital such adjustments shall be made as are necessary to arrive at a statement of the correct amount.

Where a taxpayer claims additions to the capital account, the books of account will be presumed to show the true facts and the burden of proof will rest upon the taxpayer. Such additions will be accepted only to the extent and under the conditions stated below:

(1) Amounts which have been expended in the past for the acquisition of plant, equipment, tools, patterns, furniture, fixtures, or like tangible property, having a useful life extending substantially beyond the year in which the expenditure was made, and which have been charged as current expenses, may (less proper reduction for depreciation or obsolescence) be added to the surplus account in computing invested capital

when such assets are still owned and in active use by the taxpayer during the taxable year. Special tools, patterns, and similar assets shall not be assigned any value if their cost has been recovered through having been included in the price of goods. If their cost has not been so recovered and they are held for only occasional use, they shall not be assigned a value in excess of the fair value based upon the earnings actually arising from their current use. Assets of this kind not in current use shall not be valued at more than their nominal or scrap value.

(2) Amounts expended in the past for good will, trade-marks, trade brands, franchises, and other intangible assets of a like character, are controlled by the language of the statute, which provides that such assets "shall be included in invested capital if the corporation or partnership made payment bona fide therefor specifically as such in cash, or tangible property." The Commissioner of Internal Revenue will recognize additions to invested capital on account of intangible assets only if such assets have been explicitly paid for in the manner prescribed by the statute. Where expenditures have been made for the general development of intangible assets, and charged as current expense, no readjustment thereof will be allowed.

(3) Amounts under (1) and (2) above, expended on or after March 1, 1913, will, in the case of a corporation, be limited strictly to items which have not been deducted in computing taxable income upon its income tax return. Whenever a corporation has claimed and the department has allowed a deduction in respect to its income tax, the item upon which the deduction is based shall not be restored to the surplus account nor included in the invested capital.

(4) The taxpayer shall in his return to the Commissioner of Internal Revenue make a statement of the proposed additions, specifying the kinds and amounts of property involved, the years in which the expenditures were made, and the method followed in distinguishing between capital outlays and current expenses.

(5) The taxpayer shall also show that adequate provision has been made for the depletion, depreciation, or obsolescence of such of the assets so acquired as are, under the rulings of the department, subject to recognized depreciation.

65. Invested capital of insurance companies.—(a) The invested capital of a **mutual insurance company** will be deemed to consist of the sum of (1) any surplus or contingent reserves maintained for the general use of the business, plus (2) any legal reserves the net additions to which are included in the net income subject to the tax—subject to the restrictive provisions of article 44 requiring the exclusion of tax-free assets other than obligations of the United States.

(b) The invested capital of a **stock insurance company** will be deemed to consist of its capital stock, paid in or earned surplus and undivided profits (subject to the same restrictive provision or art. 44), computed in accordance with the provisions of article 53.

INVESTED CAPITAL—INDIVIDUALS

66. Items included in invested capital.—Subject to the limitations stated in these regulations the invested capital of an **individual** is measured by the total of three items:

(1) Actual cash paid into the trade or business.

(2) Tangible property paid into the trade or business.

(3) Patents and copyrights, and good will, trade-marks, trade brands, franchises, and other intangible property. (See art. 68.)

67. Valuation of tangible property.—Subject to the requirements of article 42 as to allowance for depletion, depreciation and obsolescence, valuation of tangible property will be as follows:

In the case of tangible property purchased with cash, the valuation will be based upon the cost (estimated if not known) in cash at the time purchased.

In the case of tangible property paid in as such prior to January 1, 1914, the valuation will be based upon its actual cash value as of that date. Adequate evidence of such value must be furnished by the taxpayer.

In the case of tangible property paid in on or after January 1, 1914, the valuation will be based upon its actual cash value at the time of payment.

It will be presumed that the tangible assets employed in the trade or business have been acquired with cash which has been either paid in directly or derived from earnings of the trade or business; but the taxpayer will be entitled to show that such assets were paid in as tangible property.

68. **Valuation of intangible property.**—Patents and copyrights, and good will, trade-marks, trade brands, franchises, and other similar intangible assets may be included in invested capital at a value not to exceed the actual cash paid therefor or the actual cash value at the time of payment of the tangible property paid therefor, but only if bona fide payment was made therefor specifically as such in cash or tangible property.

69. **Profits earned during taxable year may be included.**—The restriction in respect of undivided profits earned during the taxable year which is imposed upon corporations and partnerships does not apply to individuals, and therefore, unless otherwise shown, the profits of the taxable year remaining in the trade or business will be deemed to have arisen ratably throughout the year, and the capital at the beginning of the year may be increased by the total amount of such profits remaining in the trade or business averaged monthly over the year.

70. **Rule for computing invested capital.**—Where an individual keeps books of account his invested capital will be found in his capital account (under whatever name it may be called) after making therein any adjustments or corrections required by these regulations, provided that the assets other than those not allowed to be included equal or exceed the amount of such capital account. Otherwise the invested capital shall be the amount of such assets.

Where an individual does not keep books of account he should prepare and preserve a statement as at the beginning of the taxable year and as at the end of the taxable year, showing in full all his assets valued in accordance with these regulations, and all his liabilities. The excess of such assets over such liabilities at the beginning of the year and again at the end of the year will constitute the invested capital of the individual on those dates, respectively, provided, that in each case the assets other than those not allowed to be included equal or exceed the amount of such excess. Otherwise the invested capital shall be the amount of such assets. The amount of the difference between the capital thus shown as at the beginning of the year and at the end of the year will, in the absence of evidence to the contrary, be deemed to have arisen ratably throughout the year, and the capital at the beginning of the year will be increased or decreased, as the case may be, by such amount averaged monthly over the year.

If an individual is engaged in more than one trade or business having invested capital, then his invested capital for the purposes of computing the deduction and applying the rates of taxation will be determined by taking the total invested capital of all such trades or businesses.

The terms "assets" and "liabilities" as used in this article relate only to the assets or liabilities of the trade or business.

NOMINAL CAPITAL

71. Application of section 209.—Section 209 (see art. 15) applies primarily to occupations, professions, trades and businesses engaged principally in rendering personal service in which the employment of capital is not necessary and the earnings of which are to be ascribed primarily to the activities of the owners.

In determining whether a trade or business is taxable under article 15 no weight will be given to the fact that it is carried on by means of personal service unless the principal owners are regularly engaged in the active conduct of the trade or business.

72. Application of section 209 not to be affected by mere size of capital, form of organization, etc.—Business concerns which render professional or personal service and are of the class normally taxable under article 15 shall not be taken out of that class merely because of the size of the capital if the employment of such capital is necessitated by delay and irregularity in the receipt of fees, etc., or if such capital is wholly or mainly used as a fund from which to advance salaries, wages, etc., or to provide office furniture, accommodations, and equipment, nor because of the form of organization, whether corporation or partnership, nor in the case of a partnership because of the number of partners.

73. Agents and brokers.—Agents and brokers requiring and using no capital or merely a nominal capital in their business are taxable under article 15, but commission houses regularly employing a substantial amount of capital, whether to lend to principals or to carry goods on their own account, are not deemed to be agents or brokers and are taxable under the provisions of article 16.

74. Meaning of ''nominal capital''; businesses which will not be deemed to have nominal capital.—The term ''nominal capital'' as used in section 209 means in general a small or negligible capital whose use in a particular trade or business is incidental. The following will not be construed as businesses having a nominal capital for purposes of excess profits tax:

(a) A business which because of conditions arising from the war or exceptional opportunities for profits earns a disproportionately high rate of profit during the taxable year, if it belongs to a class which necessarily and customarily requires capital for its operation. In the determination of doubtful cases stress will be laid upon the normal relation of net income to capital during pre-war years;

(b) Corporations which, although their capitalization is nominal, employ a substantial amount of capital in their business;

(c) A business having a substantial capital, but whose invested capital within the meaning of section 207 is reduced to a nominal amount by the operation of the restrictive clauses of that section, e. g., where the capital, consisting originally of a small amount of cash paid in, has since appreciated in value, or where the capital is largely covered by indebtedness or consists principally of tax-free securities or of intangible assets built up or developed by expenditures which have been regularly deducted as items of current expense.

RETURNS

75. When a return of information as to the invested capital and net income for the pre-war period will not be required.—For the purposes of the excess profits tax, a return of information with respect to the invested capital and net income for the pre-war period will not be required of a corporation, partnership or individual in the following cases:

(1) If the taxpayer accepts the minimum percentage, viz., 7 per cent, as the percentage to be used in computing the deduction under article 21; or

(2) If the trade or business is taxable only at the 8 per cent rate under article 15.

This article must not be construed as not requiring a return of information as to all facts which may be necessary for the ascertainment of the capital and income for the taxable year whenever such a return is required by the Commissioner of Internal Revenue.

76. **A married woman may make separate return.**—A married woman who is a sole trader or is entitled to any taxable income to her sole and separate use may, for purposes of the excess profits tax, make a separate return in the same manner as any other individual.

77. **When affiliated corporations must furnish information as to intercorporate relations.**—For the purpose of the excess profits tax every corporation will describe in its return all its intercorporate relationships with other corporations with which it is affiliated, and will furnish such information in relation thereto as will enable the Commissioner of Internal Revenue to compute the amount of the tax properly due from each corporation on the basis of an equitable and lawful accounting.

For the purpose of this regulation two or more corporations will be deemed to be affiliated (1) when one such corporation owns directly or controls through closely affiliated interests or by a nominee or nominees, all or substantially all of the stock of the other or others, or when substantially all of the stock of two or more corporations is owned by the same individual or partnership, and both or all of such corporations are engaged in the same or a closely related business; or (2) when one such corporation (a) buys from or sells to another products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or (b) in any way so arranges its financial relationships with another corporation as to assign to it a disproportionate share of net income or invested capital.

78. **When affiliated corporations may be required to make consolidated return.**—Whenever necessary to more equitably determine the invested capital or taxable income, the Commissioner of Internal Revenue may require corporations classed as affiliated under article 77 to furnish a consolidated return of net income and invested capital.

Where such consolidated return is required it may be made by any one or more of such corporations or by all of them acting jointly; but if such affiliated corporations, when requested to file such consolidated returns, neglect or refuse to do so, the Commissioner of Internal Revenue may cause an examination of the books of all such corporations to be made and a consolidated statement to be made from such examination. In cases where consolidated returns are accepted, the total tax will be computed in the first instance as a unit upon the basis of the consolidated return and will be assessed upon the respective affiliated corporations in such proportions as may be agreed among them. If no such agreement is made the tax will be assessed upon each such corporation in accordance with the net income and invested capital properly assignable to it.

ASSESSMENT AND COLLECTION

79. **Assessment and collection governed by income tax regulations.**—All excess profits taxes to which any taxpayer is subject shall be assessed and collected at the same times and in the same manner as provided with respect to income taxes in the income tax regulations in so far as the same are applicable.

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(Figures in **italics** refer to law)